TAKAFUL: AN ISLAMIC INSURANCE INSTRUMENT

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Abstract

The Takaful concept evolved from individual common interest from the Industrial era of the early 1900's. Only eighty million out of the world's 2.5 billion poor are currently covered by some form of micro insurance. Only 3 percent of the poor are insured in India and China and only 0.3 percent of the poor are insured in Africa. In 23 of the poorest 100 countries in the world, there is currently no identified micro insurance activity. The majority of the population is in the low-income bracket. On top of that, society's awareness on the importance of insurance is rather low. In this paper, it will be stressed that efforts are still needed to be directed towards educating the public on Islamic insurance, to appreciate the protection aspects that insurance can offer. Conventional insurance involves the elements of uncertainty, gambling and interest, all of which are unacceptable under Islamic law. There are anxiety among Muslims regarding the inconsistency of conventional banking and insurance in compliance with Islamic laws. This allowed the creation of a new industry, *takaful*, which offering risk protection and savings products to the world's 1.6 billion Muslims. One of the greatest challenges facing the *takaful* industry is the misconception that it is for Muslims only. *Takaful* products have attracted even the non-Muslim communities, despite the obvious religious and cultural differences. Nonetheless, the interest shown by non-Muslims and the support of Muslims is not enough to promote the awareness and the growth of *takaful* and what it has to offer. It is this lack of awareness that presents one of the greatest challenges to the development and growth of the national and global industry.

Introductory remark

The fact that the *takaful* insurance is available to Muslim as well as non-Muslim people is of paramount importance. I repeatedly say so in this article and ask the reader to bear with me.

Introduction

The economic recession is fast becoming a world economic catastrophe. This economic crisis is the worst ever, since the Great Depression in the United States in 1930. This crisis breathes fresh opportunities to the insurance industry. Amidst the impending global economic crisis *takaful* is set to continue concentrating on upward business growth. Although facing economic crisis, the low market penetration in the *Shari'ah* insurance opportunity creates an attractive opportunity for the insurance players to continue to grow and prosper.[1]

In Islam, the basic principle of investment is that reward must be accompanied by risk. *Takaful* businesses cannot therefore failed to invest in investments which are debt based, have a guaranteed or minimum return on the investment or based on *haram* practices (casinos and gambling companies).[2] Takaful, is the Islamic answer to the modern concept of insurance. In Islam, insurance is free from gambling and interest.[3]

Origination of takaful

The concept of *takaful* or Islamic insurance, has been familiar for centuries and was practiced by the Muhajin of Mecca and the Ansar of Medina, following the hijra of the Prophet Mohammed over 1400 years ago.[4]

*Takafu*l derived from the *'aqilah* and *diyah* systems whereby people of a given tribe would come to the financial rescue of one of its members should he face an unexpected liability such as paying for the blood money (*diyah*).[5]

Takaful is an Arabic word stemming from the verb "*kafal*" which means to take care of one's needs or "guaranteeing each other."[6] According to this scheme, the members or the participants in a group jointly agree to guarantee themselves against loss or damage. The entire group would assist the incumbent person to indemnify his loss and to provide him with financial help. *Takaful* is a legally binding agreement between all the participants of the scheme to pay any of its members who suffer a loss as specified in the *takaful* policy document. According to Catherine[6], it is an Islamic system of mutual insurance built around

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[1] Ahmad, Saaiful Yazan (2009). *Takaful in Indonesia: Business Growth amidst Economic Turmoil*. July. icmif Takaful: no. 17..
[2] Anwar, Habiba (2008). *Islamic Finance: A Guide for International Business and Investment*: 141.
[3] Saleh, Nabil A (1986). *Unlawful gain and legitimate profit in Islamic law. Riba, gharar and Islamic banking*: 100.
[4] Anwar (2008): 129.
[5] Manjoo, Faizal (2007). *Why Different Takaful Models in the World?:* Number 10: May 2007. sabbir@icmif.org. www.takaful.coop
Angelo Venardos (2005). *Islamic Banking and Finance*: 86.
[6] Stagg-Macey, Catherine (2007). *An Overview of Islamic Insuranc*e. Number 8: January .

the concept of donation. *Takaful* scheme has evolved from the teachings of Islam, on the basis of the *Qur'an* and the *Sunnah*. The Holy *Qur'an* says: "Help ye one another in righteousness and piety, but help ye not one another in sin and rancour."[7]

Meaning of takaful

Takaful literally means "mutual guarantee" or "guaranteeing each other."[8] Under *takaful*, resources are pooled to pay for events/losses that individually none of the members of the pool could afford. For example, a group of people collectively use their combined money to pay for events and large expenses such as births or marriages, or if a financial loss occurs to a member of the group. It is a form of mutual insurance and is not dissimilar to the mutual cooperative schemes that exist in Europe and the United States.[9]

Takaful is based on the concept of mutual cooperation, where the insured is also the insurer and therefore shares in the profit or loss of the institution to which they are paying (the contribution) to.[10] *Takaful* exists primarily to spread a risk and to alleviate a financial loss suffered by somebody. Unfortunately in our contemporary commercial ethos this benevolence has become meaningless. The element of philanthrophy and benevolence should be reflected in *takaful* to differentiate it from conventional insurance. If one adulterates this spirit underpinning *takaful* and treats it as a pure regulated and standardized commercial venture then the *Shari'ah* spirit may be dishonored.[11] There must be cooperative principles in *takaful*, but there need not necessarily be Islamic principles in conventional mutual or cooperative insurance.[12]

For any legal system to survive, especially in an era of globalization and universalism, one should allow *takaful* to evolve. This proves the versatility of Islamic law.

Development of takaful

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[7] Ali, Kazi Md. Motuza (2008). *Present Scenario and Future Potentials of Takaful*: 1 at plicl@bdonline.com
[8] Anwar (2008): 129.
Ahmad, Mohamad Salihuddin (2007). *Takaful in Southeast Asia: The Growing Pains and Challenges?* Number 11: September. The Malaysian Takaful Act 1984 defines *takaful* as "a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose."
DiVanna, Joseph & Shreih, Antione (2009). *A New Financial Dawn. The Rise of Islamic Finance*: 66.
[9] Anwar (2008): 129.
[10] Anwar (2008): 138.
[11] Manjoo (2007): May. Number 10.
[12] Stagg-Macey (2007): Number 8.

In modern day contexts, the first *takaful* company was established in 1979 – the Islamic Insurance Company of Sudan, was founded in Sudan by Faisal Islamic Bank in January, 1979.[13] The Bank's *Shari'ah* Supervisory Board, approved this endeavour, and in January 1979, the Islamic Insurance Company was established as a public company (under the *Companies Act* 1925). In Malaysia, the Islamic Insurance Company was established as a private limited company. The Malaysian government took steps to form a special body known as "Task Force" on the establishment of Islamic insurance in Malaysia. In its report to the government, the task force suggested that an Islamic insurance company should be established in Malaysia. The Malaysian government then promulgated legislation known as the *Takaful Act* 1984, which regulates the Islamic insurance (*takaful*) of Malaysia.[14]

In 1985, the Council of Islamic Scholars in Mecca approved *takaful* as a *Shari'ah*-approved alternative to the conventional insurance system. This led to mutual *takaful* companies being established in different Muslim countries, including Dubai, Bahrain and Malaysia.[15]

There was a concerted effort by insurance professionals and trained *Shari'ah* scholars to develop a *Shari'ah*-compliant *takaful* business model that allowed for a shareholder structure. Malaysia developed the *Takaful Act*, 1984, which gave rise to the establishment of Syarikat Takaful Malaysia Berhad as the first *takaful* company in Malaysia and the Far East region. Currently, Malaysia has the most mature *takaful* businesses operating alongside conventional banking and insurers.[16]

For the past 20 years, Malaysia, in the Far East, has been at the forefront of *takaful* development. In the Middle East, *takaful* has developed in Saudi Arabia, Bahrain, Iran and Qatar with new operations recently opening in Egypt, United Arab Emirates and Kuwait. Steps have also been taken in Europe and the US. There is no doubt a tremendous opportunity for *takaful* in those Western countries harbouring large Muslim communities. The potential for *takaful* is enormous. For comparison, in the United Kingdom 12.4 percent of GDP is expended on insurance whilst the figure is 9.4 percent in the United States.[17]

According to M Khan, 2008 there were 84 Takaful operators in 2008. In a 2007 report on Takaful Standard & Poor the GCCC Takaful market was growing at 40% per year while the 2007 Oliver Wyman report stated that worldwide annual Takaful premium potential was $20 billion (in 2007 $4 billion). Khan 2008, predicted a huge increase in Takaful over the next ten years.

Modus operandi of takaful

[13] Anwar (2008): 8, 130.
[14] Ali K.: 4.
[15] Anwar (2008): 130.
[16] Anwar (2008): 131.
[17] Stagg-Macey (2007): Number 8.

Contributions are made into the risk pool. From this pool, direct, indirect expenses and claims are paid. If there is a surplus, this is shared amongst the participants. Deficits are also made up with additional contributions from participants or with an interest-free loan from the operator.

Takaful generally means joint guarantee. It is an understanding among a group of people who agree to reciprocally guarantee each other financially should any event occur. The basic objective of a *takaful* contract is to pay from a common fund, which is set up by the participants of the scheme.[18]

The operation of *takaful* practices is supervised by an independent body called the *Shari'ah* Supervisory Board or Council. The establishment of a *Shari'ah* Supervosiry Board is a prerequisite before the commencement of the *takaful* operation.[19]

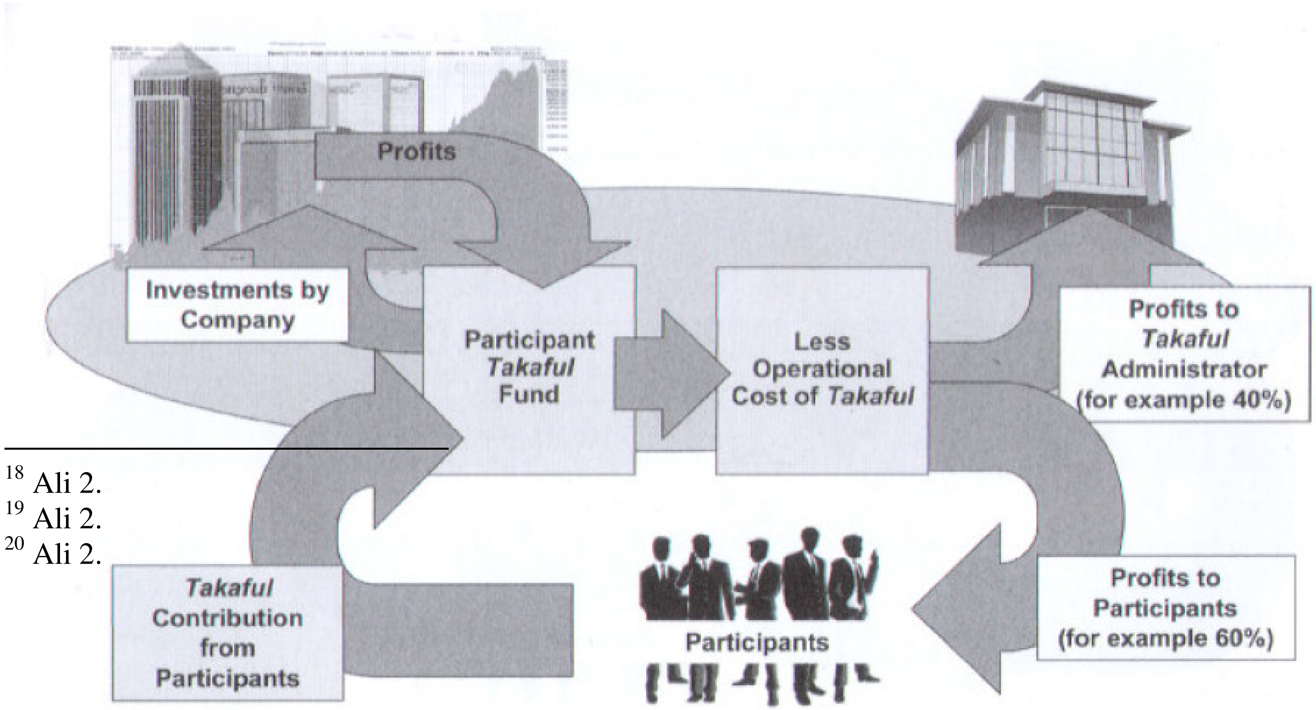
Takaful has emerged as a profit-sharing business venture between the Operator and the individual members of a group of participants who desire to reciprocally guarantee each other against certain loss or damage that may be inflicted. *Takaful* contracts are based on the principles of *mudarabah* (limited partnerships), which means profit and loss sharing. Any surplus or deficit of the *takaful* operation has to be shared by the participants, or the members themselves. It means that when a *takaful* scheme is operated on commercial basis, the surplus has to be shared between the operator and in the participants in accordance with the principles of *mudarabah*. The concept of *tabarru* (donation) is also incorporated in a *takaful* life scheme. This means a participant will agree to relinquish a certain amount of *takaful* contributions to fulfill his obligation of mutual help and joint guarantee, should any of the fellow participants suffer a loss.[20]

oseph DiVanna and Antoine Shrei (2009), identifies three different Takaful models, namely the *Mudarabah* Model, the *Wakala* Model, and the *Wakala Waqf* Model.

DiVanna and Shreih portray the *Mudaraba* Model as follows:

Mudaraba Model

The mudarabah takaful model demonstrates a clear distinction between the business of takaful or insurance and the business of investing funds mobilized from policy



[18] Ali 2.
[19] Ali 2.
[20] Ali 2.

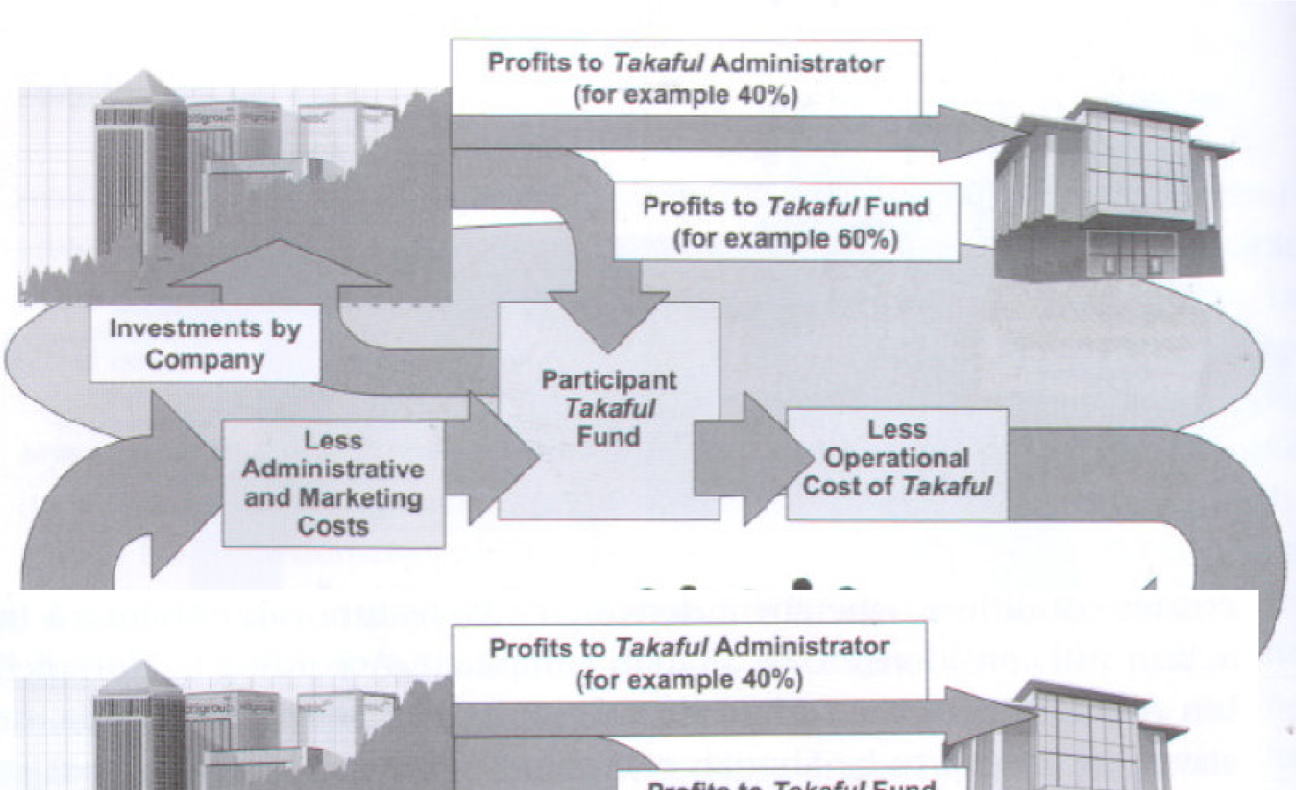
holders and or shareholders. The takaful operator seeks no returns from managing the takaful business in line with the spirit of takaful, but seeks returns from the business of investing the takaful funds under a mudarabah agreement with the policy holders for managing their funds. The policy holders assume the role of fund provider or rabb-al-maal (capital owner). As a mudarib (agent or trustee), the takaful company receives its share of profits generated on investments.[21]

Profits generated by investments less operating costs are shared between the participants with a takaful operator. The sharing of such profits are based on prenegotiated ratios agreed to by the contracting parties. The structure of the mudarabah and its inherent risk enables the takaful operator to share in the underwriting results from operations as well as the favourable performance returns on invested premiums. Losses are borne by the provider of capital. In the event of losses, the mudarib does not receive any compensation for his efforts. In a classical mudarabah contract, the rabb al-mal has no operational control over the project or investments.[22]

DiVanna and Shrei illustrate the *Wakala* Model as follows:

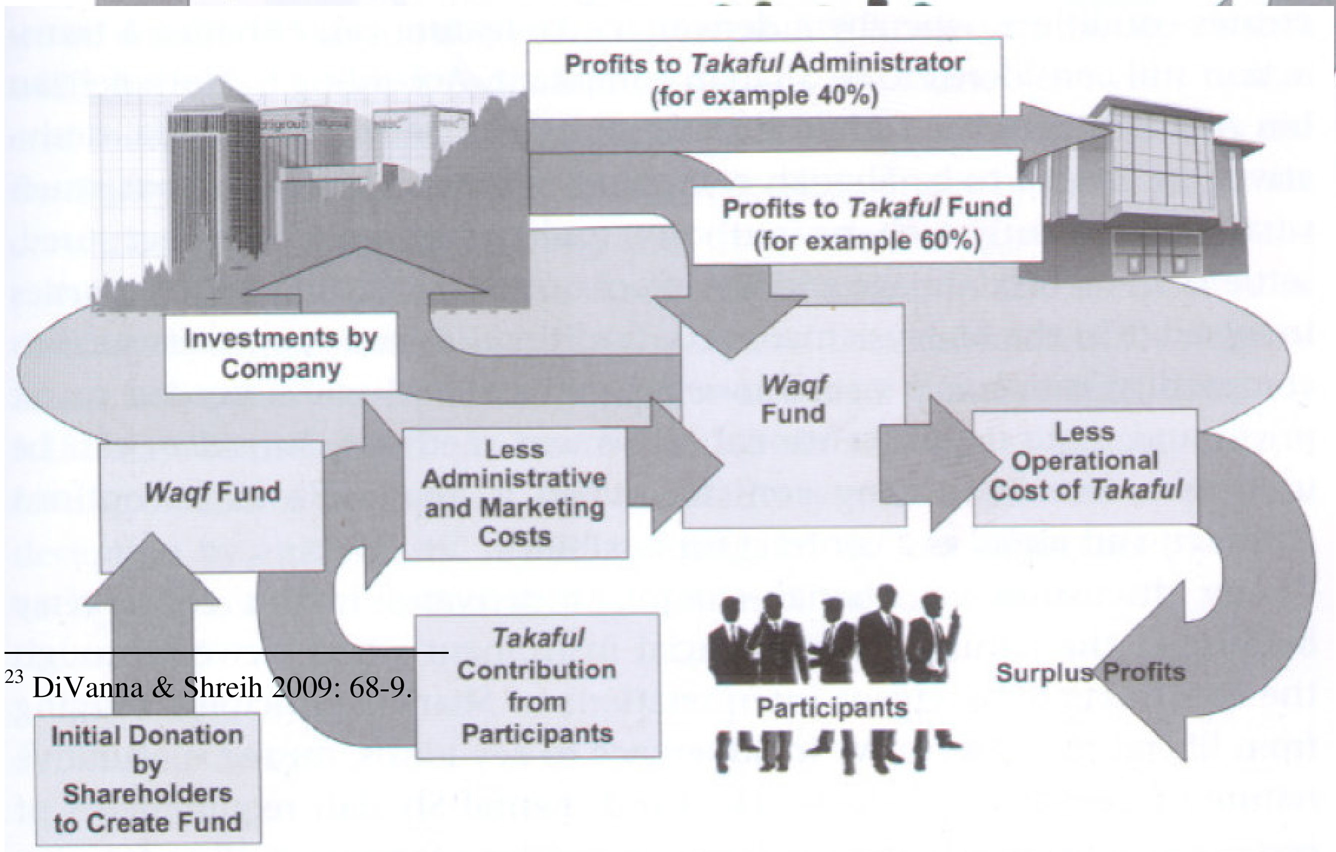
Wakala Model

[21] Joseph DiVanna & Antoine Shreih. 2009. A New Financial Dawn. The Rise of Islamic Finance. MPG Books Group, Great Britain: 67.
[22] DiVanna & Shreih 2009: 68.



Under the Wakala-based model, the operator acts as the wakeel or agent of the policy holders, and is compensated under a two-tier schedule whereby he is entitled to a known remuneration in addition to the incurrence of operational expenses on behalf of the principal. Agency fees are designed to offset operating costs and compensate and provide incentives for the takaful operator to ensure prudent underwriting, optimize investment performance, minimize direct operating expenses, equity and fairness between participants. The wakala-model offers takaful insurance on a wide range of business and personal activities such as engineering/construction, motor vehicle, property, marine, general accident, liability, personal (mortgage, acci-care, credit shield, critical care and comprehensive care) and medical.[23]

DiVanna and Shrei illustrate the Wakala-waqf-based model



Wakala-Waqf

Under this model, the operator would initially make a donation to establish a benevolent fund called the waqf

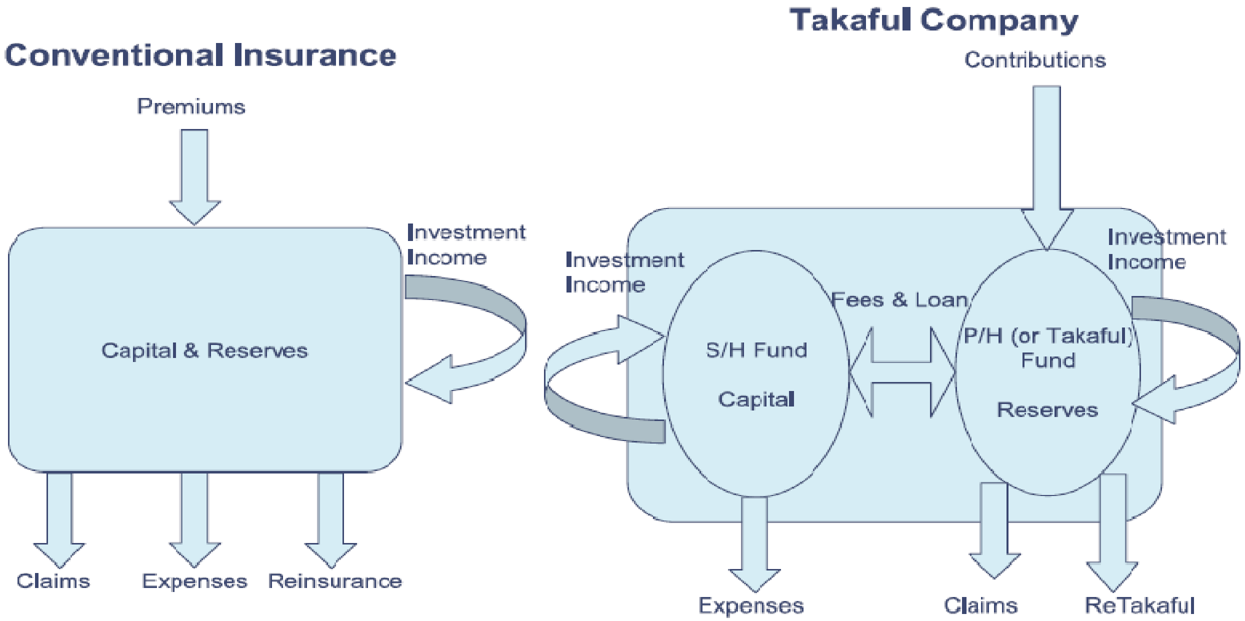
[23] DiVanna & Shreih 2009: 68-9.

fund. When this is created, the shareholders will lose their ownership rights on the waqf. This fund will be administered by the operator. The donations received from the participants seeking takaful protection will also be deposited into this fund and the combined amount will be used for investment. Profits earned will be deposited into the same fund. Participants will be given benefits from this waqf fund. The waqf fund would be allowed to form a contingency reserve fund apart from usual technical reserves. The waqf fund rules would define the basis for compensation and financial help, and rules for sharing surplus between the members and operators. The contributions received are used for investments and the profits earned would again be deposited into the same fund, which also eliminates the issue of gharar (uncertainty). Losses to the participants are paid by the company from the same fund. Operational expenses that are incurred by providing takaful services are also met from the same fund.[24]

The number of takaful companies is steadily rising. Worldwide takaful premiums are estimated to be in excess of US$2bn, representing 9 percent of the global insurance market. Takaful in not limited to Malaysia and the Middle East.[25]

Kahn describes the difference between *takaful* and conventional western model insurance as follows graphically:

[24] DiVanna & Shreih 2009: 69-70.
[25] DiVanna & Shreih 2009: 67.



The fundamental principle of the Islamic economic system, is that it stands for an equitable distribution of wealth. *Takaful* is a system where people are encouraged to contribute money for mutual help in times of need. The Islamic economic system combats the accumulation of wealth and its concentration in the hands of a small minority. The Islamic Law of inheritance provides for the shifting and distribution of wealth in a manner of which other legal and economic systems are ignorant. It divides the estate of the deceased over a wide range of beneficiaries and not on a single heir to the exclusion of all the others. The nominee in a family *takaful* scheme is only a trustee and the policy money need to be distributed to all the heirs.[26]

With the *takaful* scheme financial responsibilities are shared to assist each other. It provides mutual financial aid and assistance to those who are members of the *takaful* scheme. It has its origin in the concept of collective sharing of individual's loss. *Takaful* is being practiced now as an alternate of the conventional insurance system. This is an Islamic way of mutual assistance to deal with uncertainties of life.

Advantages of takaful

[26] Ali 6.

Under *takaful* the up front costs are minimized. Business can be transacted immediately. In this way risk is capped and costs become predictable, whereas under the conventional system, the operator has to invest in software licences, hardware, expensive IT skills. He must wait and hope for maybe one or two years while the system is prepared for use. Additional advantages of *takaful* are the transparent charging of fees and commissions and how these features would assist a *Shari'ah* Board to decide if a *takaful* scheme was really operating in a fair, *Shari'ah* compliant way in handling deductions from its participant's contributions. The ability to hold a separate *tabaruu* fund for each class or sub-class of business and the inherent ability to manage risk in real time is regarded as a big advantage.[27]

The principles of fairness and sharing each others burden will undoubtedly extend protection to the less fortunate members of the community. In the *takaful* model, surplusses can be use for *zakat* and funds can be channeled into projects which are for the common good, such as a new school or hospital. Based on the principles of fairness, transparency, simplicity, sharing the burden, *takaful* appeals to the very greatness of the Human Spirit.[28] On the basis of this ethical dimension, *takaful* will succeed, because it is bound to succeed.[29] The *takaful* business has an explicit ethical structure which can be marketed to both Muslims and non-Muslims. The dramatic rise in the demand for *takaful* insurance, is due to this ethical nature of the product. On the basis of its ethical foundation, *takaful* ought, therefore, to be attractive to both Muslims and non-Muslims. This is an important fact which I will stress over and over again in this article.

Takaful practices are free from the elements of *riba* and other prohibited elements and is evolved around the elements of *mudaraba*, *tabarru* and other *Shari'ah* justified elements. Conventional insurance may involve *riba* and some other elements, which may not be justified by *Shari'ah* principles.[30] Although both conventional and *takaful* businesses generate profits for the shareholders, in *takaful* business the expenses paid to the shareholders are explicitly transparent – in conventional insurance they are not necessarily so.[31]

Uses of takaful

Typical uses of *takaful* are insuring property, vehicles, goods, valuables, health, accidents and life.[32] *Takaful* insurance is offered to a wide range of business and personal activities such as engineering/construction, motor vehicle, property, marine general accident, liability, personal (mortgage, acci-care, credit shield, critical care and comprehensive care) and medical.[33]

[27] Ferguson, Tony (2008). *"Takaful 2.0" Using the Power of the Web to Realize the Global Potential of Takaful*. Number 15.
[28] Ferguson (2008): Number 15.
tony.ferguson@unirisx.com
[29] Ferguson (2008): Number 15.
[30] Anwar (2008): 142.
[31] Anwar (2008): 141.
[32] DiVanna & Shreih, Antoine (2009): 66.

Hitches/bottlenecks in takaful operations

Takaful products reveal themselves in emerging markets, and as such, they face challenges such as immature banking infrastructure and poor communications infrastructure. On top of this, there is little infrastructure for the new business. Many of the challenges facing *takaful* operators are strategic as this formative market tries to establish itself. Skills and resources can be borrowed from conventional insurance markets.[34]

As *takaful* originates from an Islamic concept, one of the greatest challenges facing the *takaful* industry is the misconception that it is for Muslims only.[35] In, for example, multi-racial Malaysia, *takaful* products have attracted even the non-Muslim communities, despite the obvious religious and cultural differences. Nonetheless, the interest shown by non-Muslims and the support of Muslims is not enough to promote the awareness and the growth of *takaful* and what it has to offer. It is this lack of awareness that presents one of the greatest challenges to the development and growth of the national and global industry.[36]

Another stumbling block that has to be overcome, is that the financial strength, stability and standards of conventional insurers are established and known. These conventional insurers have been in the industry for many years and their service levels are more obvious than those of *takaful* operators. To overcome this problem, is to offer a wider range of *takaful* products as an alternative to those offered in the conventional market. The needs of the lower income groups must also be addressed. Micro-*takaful*, a concept of providing affordable cover to the poor, come to mind.[37]
According to the Lloyds Micro Insurance Report, November 2009, "Micro Takaful products, also known as Sharia Microinsurance can increase the outreach of insurance to low income groups who may hesitate to buy conventional insurance out of religious considerations. Lloyds further reports that Allianz Life Indonesia offers a micro takaful life insurance that primarily provides coverage in case of the death of a family breadwinner. According to Jens Reitsch, CEO of Allianz Life Indonesia, the product is the first of its kind sold by an international insurer. Similar products being planned include health insurance and property coverage against natural disasters.

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[33] DiVanna & Shreih, Antoine (2009): 69.
[34] Stagg-Macey (2007): Number 8.
[35] DiVanna & Antoine Shreih (2009): 67. Takaful is not limited Malaysia and the Middle East. In 2008, the Muang Thai Group formed a joint venture with the Islamic Bank of Thailand to offer Islamic insurance throughout Thailand.
[36] Ahmad Mohamad Salihuddin (2007): Number 11.
[37] Ahmad Mohamad Salihuddin (2007): Number 11.
Types of micro-*takaful* products are: for property: fire, rainfall, theft, agriculture, prices and floods; health: optical, surgical, out-patient, dental, dread diseases and hospitalization; disability: permanent, partial, total, temporary and dismemberment, life insurance: "transition funds," pensions, endowments, funeral expenses. education life (http://www.LearnIslamicFinance.com)

The fact that non-Muslims have come onboard to distribute *takaful* products surprised many and initially offended some. The fact that some continue to believe *takaful* is only for Muslims must be challenged and addressed.[38]

Takaful and its interaction with the conventional scheme

The global *takaful* industry is growing at 10-20 per cent *per annum*, compared to the growth of conventional insurance of around 9 per cent *per annum* in emerging markets, and 5 per cent *per annum* in Organization for Economic Cooperation and Development (OECD) countries. Anwar asserts that according to Moody the total *takaful* premiums will rise to $7 billion by 2015. Furthermore, some of the world's largest *takaful* companies envisage that about one-third of their premiums will come from the West by 2020.[39]

Takaful products are price competitive with conventional insurance products. *Takaful* businesses, are furthermore by their nature ethical and are structured to benefit the policyholder. As competitively-priced ethical insurance, *takaful*, has the potential to be just as successful with non-Muslim customers as it appears to be with Muslim customers.[40]

What is conventional insurance?

Conventional insurance can be defined as an agreement whereby an insurer undertakes (in return for the agreed premium) to pay a policyholder an amount of money (or its equivalent) on the occurrence of a specified event. The specified event must have some element of uncertainty about it. The uncertainty may be either the fact that although the event is bound to happen in the ordinary course of nature, the timing of its occurrence is uncertain; or the fact that the occurrence of the event depends upon accidental causes, and the event, therefore, may never happen at all.[41]

Modern conventional insurance contracts are unacceptable to Islam. Life insurance involves the use of certain elements that directly contradict the rules of *Shari'ah*. They are: *al-maisir* – this is also known as gambling; *gharar* – also known as uncertainty and *riba* – known as "interest" and can be defined as making money on money. Most conventional insurers invest in interest-bearing assets. *Takaful* is restricted to an interest-free system. A *takaful* entity must ensure that both its policyholder and shareholder funds are invested in assets which do not have *riba* and that any bank that the *takaful* entity deals with should not be involved with the practice of *riba*.[42]

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[38] Ahmad Mohamad Salihuddin (2007): Number 11.
[39] Anwar (2008): 130.
[40] Anwar (2008): 130.
[41] Anwar (2008): 139.
[42] Anwar (2008): 140.

The main difference between takaful and conventional insurance

The customers (policyholders) of the *takaful* business agree to pool their contributions and share the liability of each policyholder. So if one policyholder has to pay a claim, it is paid out of the combined pool of the policyholder's contributions. This eliminates the principle of *gharar* (uncertainty) which is not allowed within Islam.[43]

As with mutual insurance, the policyholders share in the profit and loss of the *takaful* business – that is, the policyholders all share the insurance risk. They do not give the risk to the *takaful* company (as occurs in a conventional shareholder insurance company). Consequently, if at the end of a financial year, the *takaful* business makes a surplus, this is shared between the *takaful* policyholders.[44]

The assets of the *takaful* business have to be invested in *Shari'ah*-compliant assets. For example, investments cannot be made in gambling institutions, businesses that make alcohol, businesses that sell weapons or assets that pay interest (*riba)*.[45]

The operators of the business are paid explicit fees for setting up and running the company on behalf of the policyholder. These fees should cover all the setting up costs, running costs and profit loading of the shareholders and are the only way that the shareholders are remunerated. After the fees are deducted, any surplus arising from the *takaful* business is shared amongst the policyholders only. These explicit fees are in the *takaful* contract that each policyholder signs with the *takaful* company, and are fully transparent.[46]

The structure of *takaful* companies on profit basis is totally different than conventional commercial insurers. The central idea for all Islamic insurance models is the segregation between participants and shareholders funds as the company role is only to manage participants' funds on their behalf. Any *takaful* company is usually called a "*takaful* operator" instead of an insurer. For the Islamic model, contributions (premiums) should be paid on donation (*tabarra*) in order to remove the element of *gharar* from the *takaful* contract. These two principles are considered essential elements, from the *Shari'ah* point of view, and all Islamic models have to comply with these principles.[47]

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[43] Anwar (2008): 129.
[44] Anwar (2008): 129.
[45] Anwar (2008): 129.
[46] Anwar (2008): 129-130.
[47] Tolefat, Adulrahman (2006). *Mixed Model is Best Approach*. Number 6.

Takaful practices are free from the elements of *riba* and other prohibited elements and is evolved around the elements of *mudaraba*, *tabarru* and other *Shariah*-justified elements. Conventional insurance may involve *riba* and some other elements, which may not be justified by *Shari'ah* principles. In *Takaful*, the paid premium is treated as both donation (*tabarru'*) and saving (*mudaraba*). In the conventional system, the paid premiums create an obligation against the insurer on a sale and purchase relation. The underwriting profit in *takaful*, is distributed to the policyholders. The shareholders' profit is generated from the return in the investments of the shareholder capital and expenses paid to the shareholder by the policyholders for (i) managing the company on behalf of the policyholders, and (ii) managing the policyholders' investment funds on behalf of the policyholders. In the conventional scheme, the policyholders do not get any share of the underwriting profit (except in mutual companies); shareholders' profit is generated from the company's underwriting profit plus any investment returns. Under *takaful*, the policyholder's funds belong to the policyholders on collective basis and is managed by the shareholders. Under the conventional scheme, all funds belong to the company, though separation of assets may be maintained between shareholders and policyholders for specific insurances (*eg*. with profits).[48]

End purpose of takaful

Modern *takaful* practice is similar to insurance in practice whereby the contribution amount is calculated and is fixed for a standard normal person at a certain age for a certain amount of benefit. Through participation in *takaful* schemes, participants are given the chance to assist one another. The *takaful* operator is required to accumulate as much *tabarru* funds as possible to help those in need.[49]

When somebody enters into a *takaful* scheme, he is not supposed to have any intention of making money. His intention would be to share his wealth *via* contributing money or giving his money as *tabarru* towards a fund that is used to help somebody else who requires assistance. He should look beyond worldly rewards in the knowledge that when his times comes to face death, the *takaful* operator who manages the fund shall also ease the burden of his family in the same way as he acted towards other in similar circumstances. The goal is to please God and achieve prosperity in this life and the hereafter.[50]

Conventional insurers make use of uncertainty and interest in its business practice. *Takaful* is viewed by Islamic scholars as the acceptable alternative – being guided by *Shari'ah* principles. The social relationships between the scheme members are also significant. Islam promotes cooperation and sharing.[51]

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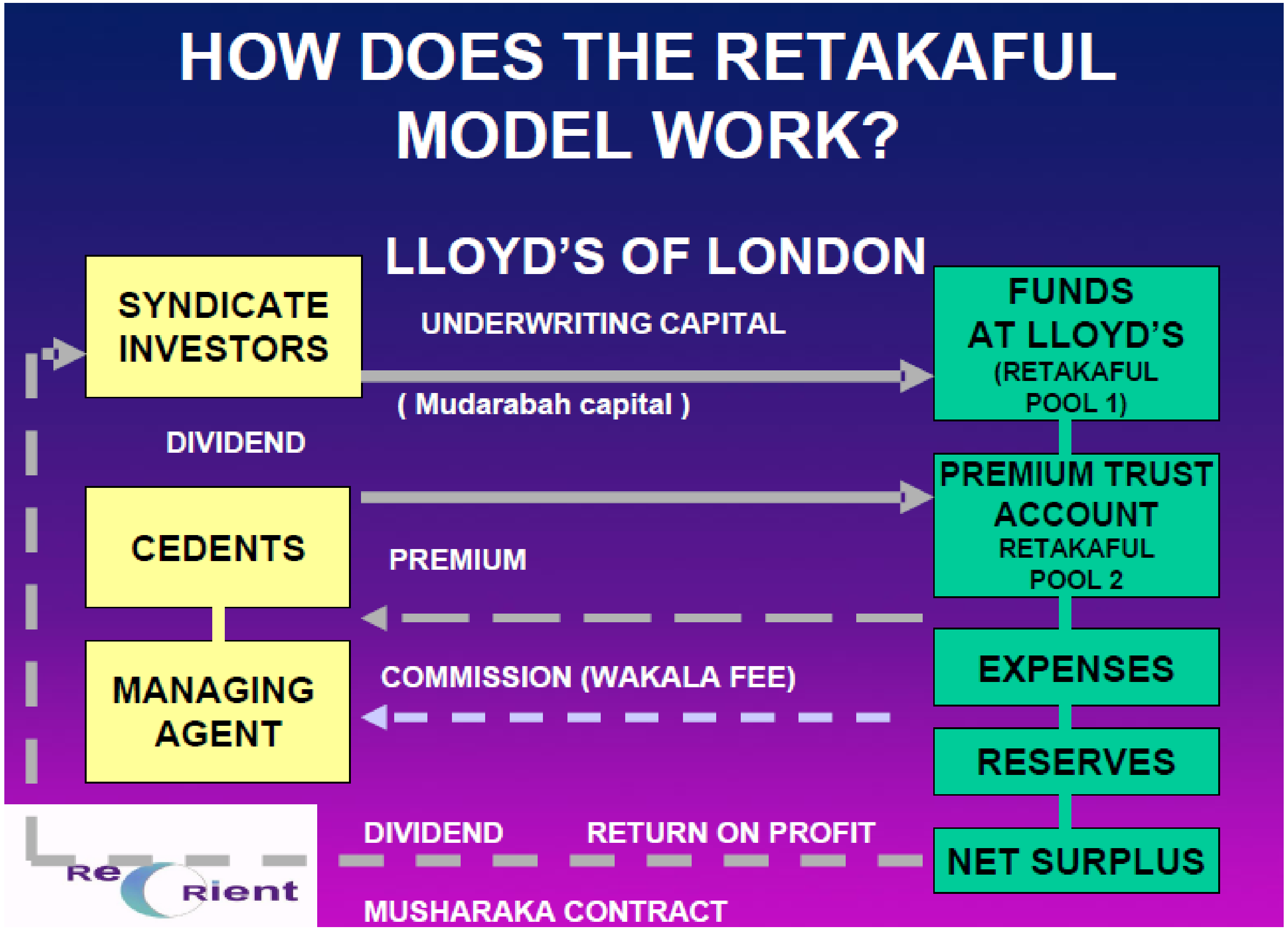
[48] Anwar (2008): 142.
[49] Daud, Roslinah. (2009). Number 18. *Underwriting Family Takaful Schemes* © 2009 ICMIF..
[50] Daud, Roslinah (2009): Number 18..
[51] Willis, Kevin (2007). *Applying Insurance Credit Ratings to Takaful Companies*. Number 9. Par.: Rating takaful companies.

Takaful and ReTakaful

In a talk to European Reinsurers in 2009 Anila Preston Wickramasinghe (CEO ReOrient Legal) defines Re*Takaful* as "an islamic alternative to conventional reinsurance based on a *Shari'ah* compliant approved concept for reinsurance" She describes the theory as one in which "the*Takaful* Company pays an agreed amount (premium) to the re*takaful* Company in return for the re*takaful* Company providing security for the assurance that the *Takaful* Company is protected against adverse risks."

She points out, however, that there are no existing re*takaful* companies are sufficiently rated or adequately capitalized to accept business from the Islamic regions. As a result many Islamic insurance companies presently cede their business to conventional reinsurers under a special temporary dispensation.

She points out that the market is growing so rapidly that this will soon be a thing of the past.
She illustrates the existing re*takaful* arrangement as follows:



The model is structured in such a way as to ensure full compliance with *Shariah* law.

Another issue of concern for her is the paucity of *Shari'ah* compliant insurance products in which re*takaful* companies can invest. Very few portfolio managers deliberately seek to structure Takaful products.

She recommends several steps by which Western Reinsurers may be of considerable assistance to Takaful Reinsurers. These include:

- “Joint ventures – with Islamic Banks, *takaful* companies or re*takaful* companies that are seeking technical partners from the Western world
- Provision of capacity to a Lloyd’s syndicate to enable a re*takaful* business to be written
- MBO or acquisition of small inadequately capitalized *takaful* companies
- Investment in emerging re*takaful* companies seeking additional capital”

At the same time she stresses the importance of the following considerations:

- “Understanding the cultural issues & perception of the end target audience. I.e. the Muslim consumer
- Working with the *Shari’ah* Scholars or *Shari’ah* consultants
- Co-ordination between legal documentation in the jurisdictions & the understanding of *Shari’ah* laws
- Understanding the regulatory & legal framework of the jurisdiction where the re*takaful* company will be located”

It can serve to benefit all people provided that to share wisdom and knowledge between Western and Islamic methods are developed. There is clear ethical balance in favour of Islamic practices and it will be highly appropriate for western insurers to learn from these and at the same for them to share their administrative expertise in those areas where Islamic law is not in conflict with western methods.

Islamic banking and Islamic insurance

Insurance in modern trade and commerce provides safety for the people as security against accidents and calamities. Likewise, modern trade and commerce cannot be conceived without involvement of insurance and banking. The conventional system of insurance and banking, which are based on interest, cannot be adopted by the Muslims as a *Shariah* compatible system. There is an intrinsic relation between Islamic banking and Islamic insurance. The progress of Islamic insurance depends on a healthy growth of Islamic banking. [52]

[52] Ali 11.

Islamic banks have already attained considerable success in the banking sector. It is only the beginning of *takaful* and it is likely to flourish in the insurance sector. To attain the desired level by both the Islamic bank and the Islamic insurance, a strong relationship needs to be built up between the Islamic bank and the Islamic insurance throughout the world.[53]

Banking and insurance without interest is feasible, viable, competitive and sustainable in the face of competition from the conventional interest-based system.

The current century is going to be the century of Islamic banking and insurance for the benefit of the people at large coupled with equity and justice for all. *Takaful* like Islamic banking has become a viable reality. *Takaful* is a financially viable and competitive alternative insurance for the Muslim countries. Islamic banking cannot be fully *Shari'ah* based unless there are *takafuls* to take their insurance business.[54]

Customers now have the choice between typical as well as Islamic insurance products. Similarity of functions between the insurance and *takaful* products cannot be denied and should be expected given that the concept of mutually helping each other, which is found in insurance, is also a concept applauded by Islam. However, from the conceptual and operational perspective, many differences were noted between *takaful* and insurance, due mainly to elements found in an insurance contract which are prohibited in any Islamic transactions like interest (*riba*), uncertainty (*gharar*) and gaming (*maysir*). Hence, *takaful* products are designed to function as any typical insurance product, but operated differently, to avoid the prohibitive elements.

Takaful and the global market

Takaful is the fastest growing area of the world insurance market. It is growing at 20 percent to 25 percent *per annum*, compared to the world average growth of conventional insurance at 5 percent to 5 percent *per annum*. The validity of this growth was made possible in the demand and the prospects of potential rewards both for the customers and entrepreneurs of Islamic insurance. In a market place, the attraction of *takaful* business may be ascribed to its connection on the Islamic *Shari'ah* as well as its being a better and a more just system. This aspect should be attractive to everyone, irrespective of any religious basis upon which the system stands. *Takaful* business has an explicit ethical structure which can be marketed to both Muslims and non-Muslims. The dramatic rise in the demand for *takaful* insurance, is due to this ethical nature of the product. I would like to stress once more as I have done repeatedly throughout these pages that on the basis of its ethical foundation, *takaful* ought to be attractive to both Muslim and non-Muslim. The *takaful* industry is, however, small in comparison to the conventional insurance counterpart. This market, therefore, needs to gain worldwide brand recognition. This is what this paper purports to do.

Conclusion

[53] Ali 11.
[54] Ali 12.

One of the greatest challenges – the misconception that takaful is for Muslims only – has been settled in this paper. Due to its explicit ethical structure, takaful can be marketed for both Muslims and non-Muslims as I have just said. In multi-racial Malaysia, for example, takaful products have attracted even the non-Muslim communities. The belief that takaful is only for Muslims, has hopefully been refuted. This, is however, not enough to cultivate a culture of awareness for takaful products. Although takaful products are faced with challenges such as an immature banking infrastructure, it can cultivate awareness by offering a wider range of takaful products as an alternative to those offered in the conventional market. The strength of takaful products to announce it awareness, lies in its ethical structure. The ethical structure of takaful, serves as offshoots for the principles of fairness and the sharing of each other's burden. This will extend protection to the less fortunate members of the community. On the basis of this common humanity, takaful products stand a chance to be accepted by both Muslim and non-Muslim, despite the obvious religious and cultural differences. It seems probable that takaful companies will attract new clients from the existing conventional insurance franchises. Takaful is being practised now as an alternative to the conventional insurance system.

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