Takaful

Unit

6

Unit 6

Takaful

Learning outcomes
By the end of this unit the learner will be able to:

- **Describe different features of Takaful**
- **Identify the Main aim of Takaful System**
- **Recognize the Models of Takaful and its Challenges**

Introduction

Insurance has become a need of businesses and individuals for mitigating risks and losses and lessening the impact of catastrophes on their lives and wealth. Financial institutions also have to take out insurance cover to safeguard against losses. When Islamic banking started functioning in the 1970s, it also required a Shar¯ı´ah-compliant alternative to conventional insurance, considered against the Shar¯ı´ah tenets due to the involvement of Riba, Gharar and gambling. To fill the gap in the cycle of Islamic finance, the system of Takaful has been developed and a large number of Takaful companies are providing services in various regions of the world.

In this unit we shall briefly discuss the reasons why conventional insurance is frowned upon, the need for and evolution of Takaful, the Shar¯ı´ah basis and features of Takaful, various models of Takaful, the status, opportunities and the challenges facing the Takaful industry. Giving details about the technicalities and working of the Takaful industry is not the objective. As the nature of business of banking and Takaful is different, and bankers are mostly not involved in Takaful business, the purpose of this chapter is only to introduce the reader to the main features of the Takaful system that is compliant with the Shar¯ı´ah tenets.

The Need for Takaful Cover

All human beings are exposed to risks in respect of their lives and belongings. Man is required by instinct, and as such has always strived, to safeguard himself from the risks and hazards to his life and property. As human society developed and business grew, this instinct took the form of the business of life and general insurance. Today, the insurance industry has become a necessary part of business and part and parcel of the financial system.

However, Muslim societies in general have been avoiding commercial insurance, mainly for two reasons. First, it has been considered unnecessary, as members of a Muslim society are required to help each other, particularly the victims of any misfortune. Hence, some arrangements to help traders and other communities have been in existence in Muslim societies for centuries. Many people believe that true belief in Allah and destiny means thereis no need for any such cover against death or losses to a man himself or his wealth.

Things happen with the will and order of God and to get insurance against them is considered to be questioning His actions. Second, the severe prohibition of Riba, Gharar and gambling are believed to indicate the no permissibility of conventional insurance. Further, insurance companies are involved in other forbidden businesses, including alcohol, pork, indecent entertainment and hotels with clubs and prohibited activities.

While the second reason is genuine and must be observed in order to avoid prohibitions, the first is only a myth. All human beings are invariably exposed to the likelihood of meeting catastrophes and disasters, giving rise to misfortune and suffering such as death, loss of limbs, accident, destruction of business or wealth, etc. Notwithstanding the belief in Allah and destiny, Islam provides that one must find ways and means to avoid such catastrophe and disaster wherever possible, and to lighten one's or one's family's burden should such an event occur.

Shar¯ı´ah intends to save human beings from hardship. The Holy Qur´¯an says: "Allâh intends for you ease, and He does not want to make things difficult for you." (2: 185). It further says: "Allah wishes to lighten (the burden) for you, and man was created weak" (4: 28). One day the holy Prophet (PBUH) saw a person leaving a camel in the jungle, he asked him: "Why don't you tie down your camel?" He answered: "I put my trust in Allah." The Prophet said: "Tie your camel first, then put your trust in Allah."

The idea of getting cover against risks is not intrinsically bad. In the case of genuine problems and remaining within the main Shar¯ı´ah constraints, the rule of necessity comes into play to find the proper solutions. Therefore, the scholars deemed it necessary to develop scheme or system enabling human beings to avoid misfortune and lessen the losses in a manner not against the principles of the Shar¯ı´ah.

The insurance business is conducted mostly by non-bank financial institutions (NBFIs) and the commercial banks are not allowed, in most countries, to be involved in the insurance business. However, all commercial and investment banks and other NBFIs have to resort to insurance services, either as a regulatory requirement or as an unavoidable business need.
Similarly, business, industry and individuals have been increasingly taking on the services of insurance companies to safeguard against unfortunate incidents and losses to life and wealth. While Islamic banking emerged in the 1960s and early 1970s, Islamic insurance started no earlier than 1979. This reveals that the Takaful system developed in response to demand for risk cover by Islamic financial institutions, due mainly to the fact that banking and insurance go hand-in-hand and complement each other's operations. However, it may also have positive implications for those individuals, households and businesses who have been avoiding insurance on the basis of belief.

Why Conventional Insurance is Prohibited

As indicated above, efforts to avoid risk are not against the Shar¯ı´ah tenets. Belief in God or destiny does not mean that man should be exposed to unnecessary risks, and Shar¯ı´ah accepts the basic safety requirement of human beings and their belongings. This includes protection of self, protection of one's offspring and wealth, protection against disease, illiteracy and poverty and other misfortune. Why, then, is conventional insurance not acceptable in the structure of Islamic finance?

Marine insurance was the first form of commercial insurance, initiated probably at the end of the 12th century. It took the form of a formal system in the 17th century, when the marine business developed on a massive scale. Among the Islamic jurists, Ibn Abdin, a widely respected jurist of the 19th century, was the first scholar who wrote about modern commercial insurance in detail and particularly discussed the marine insurance of his time; but he did not approve it from the Shar¯ı´ah point of view.

Different views have been expressed about the Shar¯ı´ah status of conventional insurance. The difference of opinion has arisen for two reasons: one, jurists who did not know the details and complexities involved in various forms of insurance and its structure were asked to issue edicts without sufficiently explaining the background and perspective of the issues involved, and two, there is no direct reference to practices like insurance in the Holy Qur´¯an and Sunnah. As Islamic economics and finance developed, Shar¯ı´ah scholars gained more and more knowledge and, hence, it became easy for them to analyse the system proactively.

As a result, an overwhelming majority of the Shar¯ı´ah scholars have come to the conclusion that commercial insurance is unlawful due to the involvement of Riba (interest), Qim¯ar and Maisir (gambling), Gharar (excessive uncertainty) and the invalid transfer of risk from the insured to the insurer. As a whole, it contains the element of temptation and cheating and is incompatible with the natural and ethical methods of earning money.

Riba is involved in conventional insurance both directly and indirectly: an excess on onside in the case of exchange between the amount of premiums and the sum insured is the dire involvement of Riba, while investment in interest-based businesses by the insurer refers to the indirect involvement of the policyholder in Riba-based transactions. If a claim is not made innon-life policies, the insurance company keeps almost the whole amount. There is a loss of premiums in the case of cancellation of a life insurance policy by the policyholder, while only a proportional refund is made if the insurance company terminates the cover. Gharar means Khatar and uncertainty about the subject matter and the price and the rights and liabilities of parties in commutative contracts and also involves Maisir and Qim¯ar.

Khatar refers to stipulating transfer of ownership of a property or profitability in a deal where commercial benefit is involved on both sides for any uncertain event. Hence, Khatar/Gharar would be found if the liability of any of the parties to a contract was uncertain or contingent; delivery of one of the exchange items was not in the control of any party, or the payment from one side was uncertain. Qim¯ar is found in a deal if the profit of one party is dependent on the loss of the other. It also involves Maisir, which means any deal in which monetary gains come from mere chance, speculation and conjecture and not from work, taking responsibility or real sector business.

Conventional insurance involves Khatar as a policyholder enters into a business deal in which his liability and the right both remain contingent. He loses the amount given as premium if the event of insurance does not occur, as in the case of general insurance. The insurer (company) does not know how much he will owe to the insured. In many cases, an insured also does not know how much he will pay ultimately to the insurer. In life policies, a policyholder has generally to lose all premiums that he has paid if he cancels his policy within the first two or three years of the contract.

The insurer receives premiums and undertakes to fulfill the loss or damage to life or property of the insured. It is either in surplus or in deficit if the claims are less or higher than the premiums received, respectively. This becomes a monetary or commercial transaction in which the insurer owns an underwriting surplus (UWS) or underwriting loss (UWL).

Any of the parties gains at the cost of the other. The hope of “chance profit” or gain motivates the taking of risk, the feature which makes the insurance contract a money stake or a gamble.

It is pertinent to keep in view in this regard that Gharar, or uncertainty, is prohibited when it is involved in commercial/commutative contracts. As conventional insurance is a commutative contract, any involvement of uncertainty would invalidate the contract.
At the present stage of human life, individuals, businesses and societies cannot afford to avoid such cover against losses to business. The only requirement is that the elements prohibited by the Shar¯ı´ah are excluded from any such scheme. Hence, an Islamic alternative to insurance was urgently required to fill the gap in Islamic finance. In many cases it is a legal requirement that assets underlying Islamic banking contracts have to be insured, as in the case of auto Ijarah, storage, shipment and transportation of goods, etc.

Further, Islamic banks’ clients criticized the involvement of conventional insurance as they wanted to avoid interest in all respects. In addition to that, there was a need for an alternative to life insurance, as in the case of housing finance by an increasing number of IFIs and for the benefit of individuals. IFIs also needed to offer savings and protection-related Takaful products to their customers. As such, the development of the Takaful industry was necessary to complete the cycle of Islamic finance.

The Shari’a Basis of Takaful

The approximate Shar¯ı´ah equivalent word for insurance in Arabic is “Ta’mein”, which means to reassure, safeguard and guarantee through indemnity to losses. It also denotes fidelity, loyalty, confidence and trust and refers more to guarantee than to cooperative sharing of losses among a group. This concept remained under discussion of the scholars for about a century. But the concept which finally gained Shar¯ı´ah scholars’ acceptance on a large-scale is that of Takaful, which requires that the nature of the main insurance contract should be converted to a contributory arrangement in which the losses to members may be covered from the Takaful pool on the basis of mutual help and sacrifice.

Shaikh Abu Zahra, an eminent jurist of the 20th century, has deliberated upon the subject in detail and concluded that a cooperative and social insurance scheme is, in principle, legitimate, and that non cooperative insurance is unacceptable because it contains the traits of gambling, temptation and usury that invalidate the contract. The Islamic Fiqh Council of the OIC approved the Takaful system based on mutual cooperation as an alternative to conventional insurance in 1985.

Takaful is not a new concept for Islamic commercial law. Islam accepts the right of human beings to protect their religion (belief), life, dignity and honour, property and talent. Some similar practices were in vogue in early Islamic Arab Society, like ‘A¯ qilah (kinsmen; further explained\ below), Qas¯amah (an oath that was taken from the kinsmen of the murdered; in one such case the holy Prophet paid blood money of one hundred camels of Sadaqah5) and Maw¯al¯at (a contract in which one party agreed to bequeath his property to the other on the understanding that the benefactor would pay any blood money that may eventually be due by the former).

Contemporary jurists acknowledge that the principle of shared responsibility in the system of “ ‘A¯ qilah” (kinsmen or people in a relationship) laid the foundation for Takaful. It was practised in the ancient Arab tribes and the holy Prophet (pbuh) approved it. In the caseof any natural calamity, everybody used to contribute something until the disaster was relieved. Similarly, the idea of ‘A¯ qilah in respect of blood money was based on the concept of Takaful, wherein payments by the whole tribe distributed the burden of the family in trouble. Islam accepted this principle of reciprocal compensation and joint responsibility.

In addition, such an institution of mutual help was established in the early second century of the Islamic era when the Arabs expanding trade into Asia mutually agreed to contribute to a fund to help anyone in the group that incurred mishaps or robberies during the sea voyages. On the basis of the above principles, the Takaful system as an alternative to conventional insurance embodies the elements of shared responsibility, common benefit and mutual solidarity. Every policyholder pays his subscription in order to assist those among them who need assistance. The theory of Islamic finance does not accept Gharar or excessive uncertainty in respect of rights and liabilities of the parties to a commercial contract. Hence, the concept of Tabarru‘ (donation) has been incorporated in the arrangement as the main ingredient of the contract. A participant of a Takaful policy agrees to relinquish, as Tabarru‘, the whole or a certain proportion of his Takaful contributions that he undertakes to pay, thus enabling him to fulfill his obligation of mutual help should any of his fellow participants suffer a defined loss.

Another concept and institution which provides support to the idea of mutual help is that of Waqf (endowment). Waqf in Islamic Shar¯ı´ah refers to the retention of a property for the benefit of a charitable or humanitarian objective, or for a specified group of people such as members of the donor’s family. There are three kinds of Waqf in Islamic jurisprudence: religious Waqf, philanthropic Waqf and family Waqf. Waqf becomes a separate entity which has the ability to accept or transfer ownership. The ownership of the Waqf property is transferred from the person creating the Waqf forever. Waqf property cannot be sold; only the usufruct is assigned to the beneficiaries. According to the Waqf principles, a member (donor)can also benefit from the Waqf. The beneficiaries of the Waqf in Takaful arrangements are the creator of the Waqf and the group whose members contribute for the purpose of mutual help and covering the losses to any of them.

Keeping the above in mind, the jurists have developed, over the last two or three decades, a system of cooperative risk-sharing in such a way that on the one hand, the basic prohibitions of Shar¯ı´ah are taken care of and, on the other hand, the requirements of the socio-economic and financial framework are fulfilled. The losses of the unfortunate few are shared by the contributions of the fortunate many that are exposed to the same risk on a cooperative risk-sharing basis. The funds are used by the manager/trustee for payment of claims and for business in any Shar¯ı´ah-compliant manner. The underwriting surplus or deficit belongs to the group members. The manager of the pool gets a return in the form of a fee and/or share from the profit made from the investments of the funds in Shar¯ı´ah-compliant avenues (this is the "investment profit" – different from the UWS/UWL as discussed above).

Main Objective of the Takaful System

The above discussion reveals that the main objective of the Takaful system from the policyholders 'point of view is mutual help and not earning profit or any windfall gains, as in the case of conventional insurance. In all forms of Takaful, like family Takaful (alternative to life insurance) or general Takaful, the participants agree to help one another out of their contributions at the time when any of them faces any catastrophe or incurs any defined loss. As a business venture, however, the operators can get fees and/or share the profits against their services and the policyholders/partners can share the realized profit, if any, after making up the losses incurred by the group members.

Having a family Takaful or Islamic life policy is not against virtue or piety. It does not mean that one has insured one's life; it is one of the means of providing a safeguard for offspring and is thus in line with the saying of the holy Prophet (pbuh): "It is better for you to leave your offspring wealthy than to leave them poor, asking others for help". The holy Prophet (pbuh) also encouraged the providing of security for widows, orphans and the poor, as he highlighted in one of his sayings: "The one who looks after and works for a widow and for a poor person (dependent), is like a warrior fighting for the cause of Allah (SWT),or like a person who fasts during the day and prays throughout the night".

Mutual help in the case of any catastrophe is also acclaimed in the Shar¯ı´ah. There was a concept of mutual protection practiced in the Islamic era by establishing common pools amongst Muslim traders to jointly compensate the loss to any group member due to robberies or misfortune during their trade journeys. As such, the concept of Tabarru' and virtue with other fellow beings is the main feature of Takaful business and any Takaful-based policy.

However, there is no Shar¯ı´ah issue in viewing Takaful as a business when conducted with Shar¯ı´ah compliance, transparency and fairness to all stakeholders.

How the Takaful System Works

A Takaful company serves as a trustee or a manager on the basis of Wakalah or Mudarabah to operate the business. The operator and the partners who take any policy contribute to the Takaful fund. Claims are paid from the Takaful fund and the underwriting surplus or deficit is shared by the participants. In life policies, a part of the contribution is also kept as an investment fund. The operator uses the funds in the business on the basis of Wakalah or Mudarabah. The underwriting surplus or deficit belongs to the policyholders/partners, while distribution of profit arising from the business depends upon the basis of Wakalah or Mudarabah.

The method of operations in Takaful can be divided mainly into two types: family Takaful or life policies and general Takaful. The contribution paid by the life policyholders is divided into a “protection part” (for the Takaful fund/payment of claims) and a saving/investment part if the company is working as Mudarib; if the company is working on a Wakalah basis, contributions are divided into three parts, i.e. a part as a management fee, a protection part and the investment part. The protection part works on a donation principle, according to which individual rights are given up in favour of the Waqf. In the investment/savings part, individual rights remain intact under the Mudarabah principle and the contributions, along with the profit (net of expenses), are paid to the policyholders at the end of the policy tremor before, if required by them. In the case of general Takaful, the whole contribution is considered a donation for protection and the participants relinquish their ownership rightin favour of the Takaful fund, and the UWS/UWL belongs to the participants.

There is provision of Qard al Hasan by the company to the fund if claims at any time exceed the amount available in it and the reserves are insufficient to meet the shortfall.
On the same bases of Tabarru‘, Waqf and Mudarabah, Takaful companies can arranger-Takaful, for which they pay an agreed-upon contribution from the Takaful fund to are-Takaful operator, which, in return, helps the Takaful companies in case of losses. Here, a question arises about the treatment of Tabarru‘ or donation: some people consider it synonymous with Sadaqah, or charity, that, once given, can neither be taken back nor canany benefit be derived from it. This, however, is not the case; every donation is not necessarily Sadaqah. The operators who are working on the Mudarabah model are of the view that the Takaful fund becomes a separate legal entity and the protection part of the contribution of the policyholders is considered its part in case of any claims; it is conditional on being used to pay the claims and there is an element of surplus, which may be givenback to the participants. Proportionate ownership of the contribution remains that of the participants to the extent that the funds are not used for payment of the claims.

Even if the amount is considered Tabarru‘ from the very beginning, donations to Waqf aroused for the beneficiaries in favour of whom the Waqf has been created. Like Sadaqah, here also, the person who contributes to the Waqf relinquishes his right of individual ownership; but in contrast to Sadaqah, he can benefit from the fund as one of the beneficiaries. This is why the model involving the concept of Waqf, as introduced in the Takaful business in recent years, is considered preferable to the models that operate without Waqf. The whole contribution by the policyholders or a part of it is considered a donation to the Waqf fund.
Policyholders have no claim on the donation part that is used for payment of claims. The operator invests the funds in the business and shares the profits with the Waqf fund and the policy holders get any share in the profit as beneficiaries of the fund.

In the early years when Takaful developed as a system, no distinction was made by the Takaful operators between the underwriting surplus and the “investment profit”. Even now, in many cases, sharing of profit or surplus that may emerge from the overall operations of Takaful is made only after the obligation of assisting fellow participants has been fulfilled. But in the continuing process of research and discussion, the scholars felt that the whole UWS/UWL should belong to the participants/policyholders and the Takaful operator should get a Takaful fee and/or a share in the “investment profit”.

Models of Takaful

Any form of insurance business acceptable to Islam must contain the virtues of cooperation, solidarity and Tabarru‘. Shar¯ı´ah scholars are also unanimous that there can be a commercial basis conforming to the basic characteristics of Islamic business principles. Towards this end, the scholars have suggested from time to time various models, like that of Wakalah, Mudarabah, Waqf (a kind of endowment) or Wakalah with Waqf.

There are 3 models and several variations on how takaful can be implemented.

1. Mudharabah (profit sharing) Model
2. Wakalah (agency) Model
3. Combination of both

The takaful operator is the administrator of the fund and manages the fund in trust on behalf of the participants, and the contract between participants and the operator is governed under the contract of Mudharabah or Wakalah.

Mudharabah gives the right to the contracting parties to share profit, while liability for loses is borne by the participants; and under the Wakalah model, the takaful operators earn a fee for services rendered while liability for losses is borne by participants. The fee may be varied based on the performance of the takaful operator. It can be a fixed amount or based on an agreed ratio of investments profit or surplus of the takaful funds.

Wakalah Model

The wakalah concept is essentially an agent-principal relationship, where the takaful operator acts as an agent on behalf of the participants and earns a fee for services rendered. The fee can be a fixed amount or based on an agreed ratio of investment profit or surplus of the takaful funds.

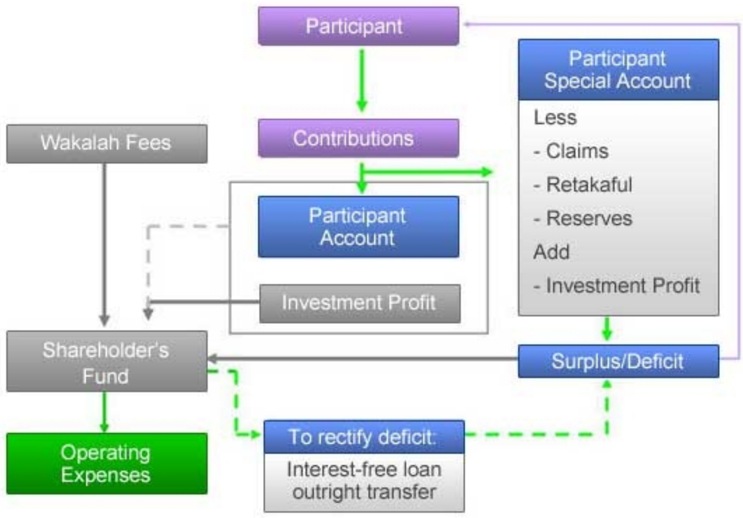

Fig: 6.1

Mudharabah Model

Under the mudharabah contract, the takaful operator acts as a mudharib (entrepreneur) and the participants as rabbul mal (capital providers). The contract specifies how the surplus from the takaful operations is to be shared between the takaful operator and the participants. Losses are borne by the participants as the capital providers. However, to protect the interest of the participants, the takaful operator is required to observe prudential rules including provision of financing rate-free loans by the operator to the takaful risk funds in the event that there is a deficiency in the takaful risk funds.

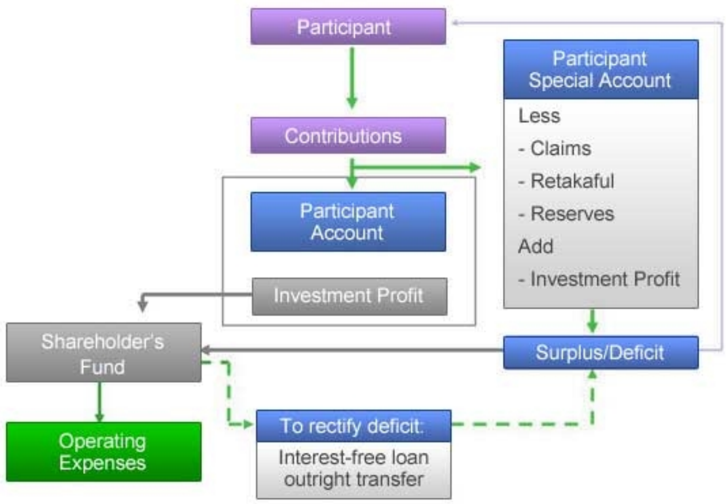

Fig: 6.2

Issues in the Mudarabah Model

While the concept of Mudarabah is highly suitable as a basis for Islamic banking business, particularly on the deposits side, it is not suitable for the insurance business. In a Mudarabah model of Takaful, amounts paid by the participants and the investment incomes are used to pay the claims, re-Takaful costs and other claims-related expenses from the general Takaful fund. Normally, the shareholders meet all management and marketing-related expenses from their share and any remaining amount is their net profit. However, in some cases, the companies charge management expenses from the Takaful fund, which is against the rules of Mudarabah. Some part of any underwriting surplus is also given to the operator, depending upon his performance.

Shar¯ı´ah scholars have raised certain issues about the validity of the Mudarabah model for Takaful on account of the following:

- In this arrangement the cooperative nature of the contract is undermined. The relationship between the participants should base on Tabarru‘ and not Mudarabah; profit-sharing cannot be applied here. A donation cannot be the Mudarabah capital at the same time.

- Sharing in any UWS makes the Takaful contract essentially the same as conventional insurance, in which the shareholders become the risk-takers – they get the UWS or bear the UWL; Mudarabah-based Takaful is rather worse, because the Takaful operators/shareholders take only the UWS, but do not bear the UWL, if any. The point is that a Takaful operator should not be a risk-taker, which he becomes in the case of the Mudarabah model.

- In Mudarabah, invested capital has to be returned along with the profit, if any; and if there is a loss, that has to be subtracted from the capital. In non-life Takaful, the paid premiums are not returned.

- The requirement to provide Qard al Hasan (in case of a deficit) in a Mudarabah contract is against the concept of Mudarabah by definition, which is a profit-sharing contract. Further, a Mudarib cannot be a guarantor to the financier.

Issues in Wakalah and Wakalah–Mudarabah Models

- Wakalah combined with Shirkah arrangements (as in the case of most Takaful companies in the Middle East that give a part of any UWS to shareholders) is subject to the same objections as the Mudarabah model. The problem arises when the Takaful operator is given a part of the UWS in addition to the operating fee as a performance incentive.

- Sharing of surplus should be among the pool members of the fund.

- The risk premium should be separately defined and related to the risk; this should be the same for similar risks, regardless of who the client is.

- For large clients, the company should reduce the operator’s fees and not the risk premium rates.

- Expenses related to initial set-up should be borne by the shareholders.

Takaful and Conventional Insurance Compared

Takaful and conventional insurance are different with respect to the objectives, structure, investment policies and returns. In conventional insurance, risk is transferred to one party – the company – and the prohibited factors of Riba, Gharar and gambling are involved. The policyholders have to pay the premiums against unknown risks in the case of general insurance. In life insurance, they get back the premiums along with interest in the case of survival and the insured amount in the case of death before maturity of the policy. In Takaful, the participants or the group members relinquish their ownership right of the amount of the donation and then the Waqf fund bears the losses to any of them and the members share the UWS/UWL. The Takaful companies manage the business and share the investment profit with the policyholders.

Although there still remains some uncertainty, it is within the group itself, all members have jointly contributed to help those among them who incur any loss and share the remainder, if any. This is why the model of Takaful in which UWS/UWL fully belongs to the participants is considered to be the best model as per the latest research. Uncertainty is further minimized by recourse to reserves and access to Qard al Hasan to the Takaful fund from the shareholders in case of need.

The risk premium in the conventional system is commercially driven, motivated by the desire for maximum profit for the shareholders; while in Takaful, its adequacy is the main consideration and the profit element is subject to the rules of equity, justice and ethics. Losses in terms of underwriting or on investment, if any, are first absorbed by the reserves, then from the interest-free loans from shareholders and then by a general increase in pricing by the company. Hence, the Takaful system has a built-in mechanism to counter any overpricing policies of the insurance companies, because whatever the amount of premium, the surplus goes back to the participants in proportion to their contributions.

There are some basic differences between life policies in the two systems. A life insurance policy under the conventional system revolves around the element of Riba, whereas the Islamic model of life policy is based mainly on the principles of Waqf, Tabarru‘ and Mudarabah. Under the conventional policies, payments to the agents are made from the assureds’ paid premiums, whereas under the family Takaful policy, the agents work for the company and thus they are paid by the company itself. With regard to the insurable interest, under the conventional system, it is usually vested to the policyholder himself should he be alive upon the expiry of the policy period. But, in the case of death of the assured within the period, the insurable interest is to be vested to the nominee, who could be the husband/wife, parents or children or any other person or entity. In contrast, under the Islamic model, the insurable interest is to be vested to the assured himself or to his heirs, according to the principles of inheritance and wills.

The idea of a conventional life policy is that if the assured dies at any time before the maturity of the policy, the nominee is entitled to recover from the insurer the whole amount agreed in the policy, while if the assured is alive upon the expiry of the policy period, he is entitled to the whole amount agreed in the policy plus interest, dividends and bonus subject to the company's policy. On the contrary, in the Takaful system, if the assured dies at any time before the maturity of policy, the company gives to the beneficiary the amount projected in the policy, which includes his investment part along with profit, any amount from the Takaful fund and the donation from the company at its discretion. In the case where the policyholder is alive upon the expiry of the maturity period, the company gives him the investment part along with profit, a pro rata share in the underwriting surplus and a dividend/bonus according to the policy of the company. In the case of premature termination, the partner is given the investment part along with profit and a pro rata share in underwriting surplus (with reduced weightages depending upon the number of years). He gets no assistance from the Takaful fund.

The distinction between conventional insurance and Takaful business is more visible with respect to investment of funds. While insurance companies invest their funds, among others, in interest-based avenues and without any regard to the concepts of Halal and Haram, Takaful companies undertake only Sharī´ah-compliant business and the profits are distributed in accordance with the pre-agreed formula/basis in the Takaful agreement.

Status and Potential of the Takaful Industry

The Takaful business has proved its viability in a period of only two decades. The first Takaful company was established in 1979 – the Islamic Insurance Company of Sudan. Malaysia started Takaful business in 1984. The system gathered momentum in Saudi Arabia and other Middle Eastern countries. It has been growing at a rate of 10–20%p.a., compared to the global average growth of the insurance industry which is, 5%p.a. A large number of Takaful companies exist in the Middle East, Far East and even in some non-Islamic countries.

There are over 60 companies offering Takaful services (including windows – 5 %) in 24 countries around the world. These countries are: Bahrain, Bangladesh, Brunei, Egypt, Ghana, Indonesia, Iran, Jordan, Kuwait, Luxembourg, Malaysia, Pakistan, Qatar, Saudi Arabia, Senegal, Singapore, Sri Lanka, Sudan, Trinidad & Tobago, Tunisia, Turkey, United Arab Emirates and Yemen. Takaful products are available to meet the needs of all sectors of the economy, both at individual and corporate levels, to cater for short- and long-term financial needs of various groups in society. Re-Takaful business has also been developed in Malaysia, Bahrain, Saudi Arabia and UAE.

At global level, however, the Takaful system has not met with such a major degree of success as has been witnessed in the case of Islamic banking. This is for two reasons:

1. The huge investment required to compete with the conventional insurance industry.

2. The changes required in regulatory requirements, as seen in the case of Malaysia, to allow Takaful to compete on equal terms with the conventional industry. Takaful business has a huge potential as there is increasing demand for a Sharī´ah compliant system, particularly with the development of the Islamic banking industry. There has been low insurance density (premiums per capita) and low penetration (premiums as a percentage of GDP) in Islamic countries, mainly because of the belief

of the majority of Muslims that insurance is un-Islamic, and that there is no alternative available to that system.

With the development of Islamic banking, there has been a significant increase in the Ijarah and home mortgages which necessitate Takaful. Also, there is a need for Takaful in cases of personal policies, like motor vehicles, health and family security. The potential may be realized only if people are given education and awareness about the features of the Takaful system, particularly about life Takaful. So far, only a small number of companies are providing comprehensive family Takaful policies. In the Middle East, only Bank Aljazira of Saudi Arabia is offering exclusive Takaful Ta'awani (family Takaful) with a full range of products like retirement, marriage, education and protection to the general public and corporate clients. Other companies are engaged mainly in composite operations.

Takaful operators need to approach the large number of individuals and groups who have not been taking out insurance cover in the past due to religious reasons. Islamic banks may like to realize this potential and thus complete the cycle of Islamic finance more quickly. In the markets or countries where a viable Takaful facility is not yet available, they may jointly establish well-capitalized Takaful companies, as long as there are no legal constraints. The main objective of these companies may be to provide Takaful services to the Islamic banks, keeping in mind all Shar¯ı´ah principles. They may also be allowed to do other market business. This would create competition in the market and a large number of general Takaful companies would be entering into the market to undertake Shar¯ı´ah-compliant business with competitive pricing.

Takaful Challenges

The basic structure of a Shar¯ı´ah-compliant insurance system has been generally accepted by the Shar¯ı´ah scholars to be essentially based on the principle of mutual help by group members. The way ahead is to improve/reform and develop the existing operational structures in respect of the models and procedures. A number of conceptual issues need to be addressed to ensure credibility and thus enhance the acceptability of the new industry.

Takaful operators should come forward to incorporate the institution of Waqf in the Takaful arrangement, as it fully conforms to the requirements of the concept of Tabarru' and is free from Shar¯ı´ah-related objections. Other problems that have to be addressed are adequate capitalization, enabling the Takaful operators to work in competition with the conventional companies, developing human resources, re-Takaful facilities and Shar¯ı´ah compliant avenues for investment of funds, standardization/harmonization of the practices and providing legal and regulatory frameworks for healthy operation of the industry.

The most important challenge that the Takaful industry is facing is creating awareness about the concept itself. The majority of the Muslim population, who have been avoiding insurance because of religious reasons, need to be assured that taking out cover against catastrophes in a manner conforming to the principles of Shar¯ı´ah does not involve any prohibitions. A Shar¯ı´ah board or an advisor and periodical Shar¯ı´ah audit are required for every Takaful company, not only for ensuring Shar¯ı´ah compliance but also for enhancing the confidence of the public with regard to Shar¯ı´ah-related issues.

Takaful companies are mostly providing general business policies. The real potential lies in family Takaful or Takaful Ta‘awani, to realize which, practitioners need to mobilize the general public in Muslim societies. For this they also need a sound financial basis. Composite business has the benefit of offering annual products, which are expense and surplus driven, allowing an early and much-needed cash flow for successful Takaful business. Family Takaful programmes, on the other hand, are cash-absorbing businesses in the early years of establishment of the company. This problem can be solved only by enhancing the capital base of the companies, which, of course, would benefit them in subsequent years.

Besides this, working in a competitive environment side by side with conventional insurance companies is, in itself, a challenge. Takaful companies must offer competitive products/services in terms of price, quality of coverage and delivery time. They will have to work with a new mindset, avoiding malpractices and using the best professional expertise. Policy holders also need to support Takaful companies and be proactive to ensure that the companies are competitive and their operations are Shar¯ı´ah-compliant in all respects. Re-Takaful availability is a problem, as only a few companies are providing re-Takaful facilities in Malaysia, UAE, Bahrain and Saudi Arabia, and that too on a Mudarabah basis.

Providing well-aware and competent manpower for the nascent Takaful industry is another challenge. Only committed, trained and experienced personnel can enhance the acceptability of the system among the public. While there are some facilities available for training in Islamic banking, facilities in respect of Takaful are almost entirely lacking. In this respect, the IRTI (IDB), the AAOIFI, training arms of the central banks and the Securities and Exchange Commission’s in countries where Islamic financial services are being developed need to work proactively in collaboration with the Takaful companies.

Lastly, in view of the process of globalization of financial services, there must be standardization of the Takaful products. This will require efforts by the AAOIFI and IFSB to prepare the Shar¯ı´ah and performance standards respectively (as in the case of Islamic banking) for standardization of services and structures feasible in the framework of mutual help. Differences of opinion with regard to the Takaful models have to be resolved. This is because reservations/differences, once expressed, would keep agitating the minds of stakeholders and thus hinder the growth of the emerging industry. To avoid this and to harmonize the practice, the Shar¯ı´ah scholars and the practitioners should collaborate for convergence on the basis of the Wakalah–Waqf model that is nearest to the principles of the Shar¯ı´ah. The regulators need to provide flexibility and ensure that the operators or practitioners perform their functions, keeping in mind the generally accepted key benchmarks, like the CAMELS tests and other performance criteria.