

# ISLAMIC INSURANCE OR TAKAFUL

## HISTORICAL BACKGROUND OF WESTERN CONCEPT OF INSURANCE

- 1. Ottoman Empire- First introduce western concept of insurance- Maritime Code 1863.
- 2. Ottoman Law of Insurance 1874-only life insurance is haram or unlawful
- Since then, western concept of insurance is practiced almost in all countries in the world

## Fatwa on Conventional Insurance

- In 1972 the Fatwa Committee declared the western concept of insurance was unlawful because of gharar, riba and maisir
- In 1982- a committee set up by the govt to study the implementation of takaful.
- Fiqh Academy of the Organization of Islamic Conference (OIC) at its gathering in Jeddah in December 1985 resolved that no form of insurance, be it life or general, had conformed to the Islamic principle

## Fuqaha Views on Life Insurance

- 1. Opponents:- Sheikh Shaukat, Abu Zaharah and others.
- Reason:-
  - i. Insuring one's life
  - ii. Betting
  - iii. Element of riba, maisir, gharar.
  - iv. Supersede the will of Allah
  - v. against the principle of mirath
  - vi No direct authority to justify it

## Fuqaha Views on Life Insurance

- 2. Justification of life insurance but in different form namely Family Takaful.
- i. mere financial transaction through mutual cooperation.
- ii. No unlawful element.
- iii. Implied model of takaful-aqilah and mudharabah.
- iv. Mutual cooperation to protect the necessities.
- v. Securing the offspring it does not supersede the will of Allah.

## 2. Justification of life insurance but in different form namely Family Takaful

- vi. Security for poor.
- vii. Protection of unexpected difficulties.
- viii. Self reliant society.

## OBJECTION TO THE WESTERN CONCEPT OF INSURANCE

- 1. Riba.
- Life insurance- insurer undertakes to pay the insured. The sum is in excess of the total premium paid. Premium = Loan
- Non-Life insurance- The insurance companies invested the premium paid in fixed interest earnings investment.

## 2. Gharar

- Uncertainty= Risk, hazard or peril
- Neither the insurer nor the insured knows the nature and extent of their rights and obligation until after the occurrence of the insured event.
- Any transaction must free from excessive uncertainty
- The insured is ignorant of the terms of the insurance.- Unacceptable reason.

## How To Free From Excessive Gharar

- 1. Mutual and Cooperative basis
- 2. The takaful coverage must be genuinely required in order to safeguard interest collectively
- 3. such coverage can only be safeguarded through the insurance mechanism.
- 4. Type of contract is Unilateral Contract- Al-Tabarruat.

## 3. Juhala

- Uncertainty per se- all particulars of the contract must be known to the parties at the time of the contract. Otherwise- invalid
- Life insurance- The insured does not know – how long he will be paying the premiums.
- Non life insurance- does not know how much the insurer will pay him in the case of insured event takes place

## 4. Maisir

- Prohibition of unearned gains.
- To court unnecessary risk by entering into a transaction with a hope of gain as well as fear of loss.
- Undertaking a risk in the spirit of speculation
- Life insurance- If dies early-Lucky= Policy money will be paid.
- Non life insurance- if the insured event occurs- Lucky. If no- gets nothing

## 5. Violation of Islamic Law of Inheritance

- Law on Nomination- insurer can nominate to any person as beneficiaries.
- S 23- Hock Hoe's Policy. Nominee enjoys full benefit of the insurance policy.
- This objection is not relevant anymore. Amendment to the Insurance Act and introduction of the Takaful Act 1984.
- In Islam- nomination is just a trustee. The policy money must be distributed –faraid.

## 6. Contravention of the Conception of Pre-Destination

- Concept of *Qada* and *Qadar*- The ultimate destiny is in the hands of Allah.
- Irrelevant- Failure to appreciate the real function of insurance.
- The insurance does not prevent pre-destined events. It only reduces the pain and suffering resulting from the insured events.
- This is in fact in line with the Islamic principle.

## 7. Objection to forfeiture of Premiums

- Insurer may forfeit the premiums that have been paid in certain circumstances.
- May forfeit in the event of avoiding non-disclosure or breach of warranty by the insured.
- Islam does not allow the forfeiture of the capital.

## Differences of Family Takaful and Life Insurance

FT	LI
Mudharabah	Loan
Trustee	Nominee
Dividend	Insured money + interest
Share of profit	Payment out of assured premium
Insurable interest- not relevant	Insurable interest is a requirement

## Origin of Takaful

- 1. Aqilah- Blood money
- The tribe had to be ready to compensate the heir of the victim.
- Compensation likes indemnity in insurance policy
- 2. S.Umar- Al-Dawawin System- Ministry to contribute money for emergency or in need.
- 3. Khairat Kematian-



## Sources of Law Affecting Takaful

- 1. Al-Quran- elements of mutual cooperation= Almaidah: 5:2. Alleviation of hardship= 2:201
- 2. Sunnah= Prophet said: Tie the camel first and then leave it to Allah
- 3. Practices of the companion- Al-Dawawin System by S. Umar.
- 4. Fatwa or Ijtihad: Ibnu Abidin=Permissible insurance in trade for merchant known as Sukra.
- Muhammad Abduh, Zarqa- agreed to the validity of Islamic insurance

## Sources of Law Affecting Takaful

- 5. Masalih Mursalah= Life, necessity. A way of providing material security.
- 6. Urf- Tribal Custom practice known as Aqilah.
- 7. Unanimous Decision of Muslim Scholars-
- Islamic Fiqh Week Syria 1961, Muslim Scholars Conference 1965 Egypt and Islamic Economic Conference Mecca 1976- Validity of insurance business except life insurance.
- International Islamic Insurance Dubai 1996 and Labuan 1997- Validity of Takaful.

## Takaful

- Mutual Guarantee= mutuality and cooperation.
- TA 1984-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.

## Concept of Al-Tabarru'

- gift or donation, which given by one in favor of someone without seeking any consideration.
- A *tabarru'* made based on the general principles of contract in which the person binds himself unilaterally by offering something valuable for the noble cause of welfare of others

## Concept of Al-Tabarru'

- participants' contributions credited mainly into two accounts; participant's account (PA) and participants' special account (PSA).
- PA- To be invested based on mudharabah
- The amount credited into the PSA is regarded as *tabarru'*, which is managed by the takaful operator to provide a security for others who deserve

## Takaful Model

- 1. Mudharabah contract : Eg. Malaysia
- TO as the entrepreneur will accept payment of the installments or contributions called *ra'sul mal*, from investors or provides of capital or fund, popularly known as takaful participants acting as *sahib-ul mal*. the takaful operators as the entrepreneur will accept payment of the installments or contributions called *ra'sul mal*, from investors or provides of capital or fund, popularly known as takaful participants acting as *sahib-ul mal*.
- income to the operator as *mudharib* is calculated at the end of the contract under the *al-mudharabah* model

- (Mr. Ahmad) buys Fire Takaful Policy. He pays the contribution for RM 1000 for a year. Takaful Operator invests the contribution paid by Mr. Ahmad in the investment company (Halal Investment Counter) according to principle of Al-Mudharabah. Takaful Operator get 10 % profit.
- So at the end the Takaful Operator will get RM 1100 (Principle + Profit).
- Then the amount of RM 1100 (In the General Takaful Fund) will be deducted for allowed cost such as Retakaful, Claims, and Reserves.
- If there is a surplus (Profit) after deduction for allowed cost, then the sharing of surplus will be distributed to both Takaful Operator and Participant 60%: 40% respectively (Based on the agreement in the contract).

## Takaful Model

- 2. Wakalah Model- Msia= Bahrain, Saudi Arabia
- a contract of agency in which a person delegates his business to another and substitutes the other in his place. The person delegated called *wakil* (agent) whose fundamental obligation is to provide his skill towards the betterment of assigned job. Thus, both the principal and the agent equally bound by each other under contract of *al-wakalah*.
- *the practice of the al-wakalah allow the operator to charge fees as income upfront or at the point the contract is incepted.*

## Wakalah Model

- Consists of contribution (*Ishtirak*) by Participants (*mushtarik*) that includes payments of fees and charges and a portion for donation (*tabarru*) to a community takaful fund. All risks are borne by the takaful fund and the annual operating results (Surplus/Loss) belong solely to the Participants. The takaful operator (*wakeel*) does not share directly in the risk, deficit or surplus.

## Wakalah Model

- Participants agree to pay specified direct expenses and to pay the takaful operator a set fee (*wakala* fees) to manage the operations on their behalf, which may include a performance fee as incentive that is charged to the surplus, if any.
- If the takaful Operator is to generate a profit from its efforts, it must manage the operations (including salaries, overhead, selling commissions, sales and marketing expenses, etc.) entirely within the disclosed *wakala* fees.
- The *al-wakala* model can be viewed as transparent as fees are clearly related to operator's operational costs.

## Characteristics of Takaful

- 1. Mutual Help
- 2. Mutual Responsibility
- 3. Mutual Protection
- Mutual insure one another.
- Relationship- not as an insurer and insured but participants and manager of the contribution money.
- 4. Free from any element of riba, maisir, juhala, excessive gharar.

## Takaful Conditions (Mutual Assistance and Cooperation)

- 1. Speciality Condition
- Compliance with the Islamic cooperative principles
- 2. Partnership Condition=
- Participants- right t entitlement of surplus profit and render liable to cover losses.
- Surplus may be paid= pro rata basis.

## Takaful Conditions (Mutual Assistance and Cooperation)

- 3. Investment Condition=
- To invest in halal sectors.
- 4. Management Condition=
- Policy to have adequate representation on the board of directors of the company to scrutinise its accounts

## Legal Issues

- 1. Takaful Act 1984:-
- Regulatory in nature and not a statutory source of the substantive law.
- S2 Takaful business= a business of takaful whose aims and operations do not involve elements opposed by the shariah.
- S 8 (5) the DG shall refuse to register takaful business unless he is satisfied that the aim and operation will not involve any element which is not approved by syariah

## 2. Substantive Law Applicable

- The TA does not specify what is to be done if there is a lacuna in law.
- Conventional insurance- CLA 1956.
- The TA does not mention Islamic law as a source of substantive law for takaful.

## 3. Takaful Contract

- Takaful contract based on mudharabah. Each terms and conditions must be made known to the participants.
- S 64- below 18 have no capacity to enter into a contract of takaful. Insurance Act- above 10 and below 16-can enter into contract + written consent of parent.
- In Islam 18 is not an age of majority. Need to depart from the strict Islamic concept.



## 4. Non-disclosure and Fraud

- There is no requirement of doctrine of utmost good faith under the TA.
- Insurance Contract- There must be “utmost good faith”. Hence impose the same duty of disclosure upon parties to contract.
- In Islam contract of mudharabah requires parties to be truthful, honest and sincere.

## 5. Warranties, Conditions and Basis

- The TA does not mention the rule on strict application of the law relating to warranties.
- Effect: Takaful contract can be avoided by the takaful co. if a wrong answer is given in the proposal form when the participants believes it to be correct.

## 6. The SSC

- The TA makes condition a provision in the AOA to establish Shariah Supervisory Council.
- The Act silents on the status of the SSC's advice.
- The function is strictly supervisory.

## 7. Licensing and Control

- A takaful co can be either company or cooperative society. The requirements:-
- 1. Meet the requirement on deposit and total asset. 2. satisfy that the aims and operations- Islamic 3. provision of the SSC in AOA.
- DG may cancel the license if the business is against syariah. But DG to refer to whom?
- Either to refer to the SSC or NSAC.

## 8. Insurable Risk

- Def: Chance of loss, the possibility of loss or uncertainty concerning the occurrence of a loss.
- Two types of risk Pure Risk and Speculative Risk. Only pure risk is insurable. Reason: would resemble wagering practice.
- Conventional Insurance is concerned with the economic problems created by pure risk. Eg. Accident =may suffer a loss.
- Speculative Risk: where either profit or loss is possible. Eg shares of common stock.

## Should the takaful be confined to Pure Risk?

- All types of risks are insurable under takaful contract:-
- 1. Takaful is based on brotherhood, solidarity and mutual assistance.
- 2. Al-tabarru concept- all types of risks are acceptable.
- 3. Speculative risk is not identical to gambling. Eg. Taxi driver who is driving his car with danger of accident. Pure Risk- Accident :Speculative Risk- loss of future gain.

## 9. Insurable Interest

- Def: Interest an individual must have in insurance coverage carried by someone else.
- Legal perspective: the party to the insurance contract who is the insured or policy holder must have a particular relationship with the subject matter of the insurance whether that be a life or property or a liability to which he might be exposed.
- The absence of this requirement under conventional insurance will render the contract illegal, void and simply unenforceable.

## Cont..

- The purpose: 1. to determine the motive for purchasing insurance and in the assignment of a beneficiary in a life insurance policy.
- 2. to avoid gambling or wagering practices.
- Eg. "A" pays premium on behalf of his wife and names her as beneficiaries= The insurance co. recognizes it coz in the event of unexpected death, the family would suffer an economic loss.
- Eg. "A" pays premium of insurance for another party let say his best friend, if that person names him as the beneficiaries. The insurance co will not issue the policy.

## Cont..

- S 152 of the Insurance Act 1996- Requirement of Insurable Interest.
- Exception to employer-employee relationship.
- The requirement of II specifies that the insured must lose financially if a loss occurs or must incur some harm if the loss takes place.

## Whether the principle of insurable interest is relevant in takaful?

- The requirement of II is not relevant under Takaful not because of to determine the motive for purchasing insurance and in the assignment of a beneficiary in a life insurance policy and to avoid gambling or wagering practices but:-
  - 1. The TA 1984 does not require this principle in family takaful or general takaful.

- 2. The nature of family takaful makes this element irrelevant as a participant participates in this scheme only for the benefit of himself and his family. He cannot do so for the purpose of benefiting or on behalf of the 3<sup>rd</sup> party.
- 3. Ab initio irrelevant coz the participant cum insured could not have any interest on his life.
- 4. The principle of takaful: takaful contract must be concluded between the participants themselves, a party who is neither insured or insurer is not eligible to participate in the contract.

Thank You

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