Takaful: Concepts and Models

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Main Topics

- Introduction of Modern Insurance
- Evaluation of Insurance Business from Islamic Point of View
- Islamic Alternative: (Review of Existing Experiences of Takaful)
- Performance of Takaful Industry

Risk and Insurance:

Risk and uncertainty are fundamental facts of life. All human activities are subject to risk, which may lead to financial or physical losses to him. Insurance is a device to cover the losses arise due to occurrence of some undesired event.

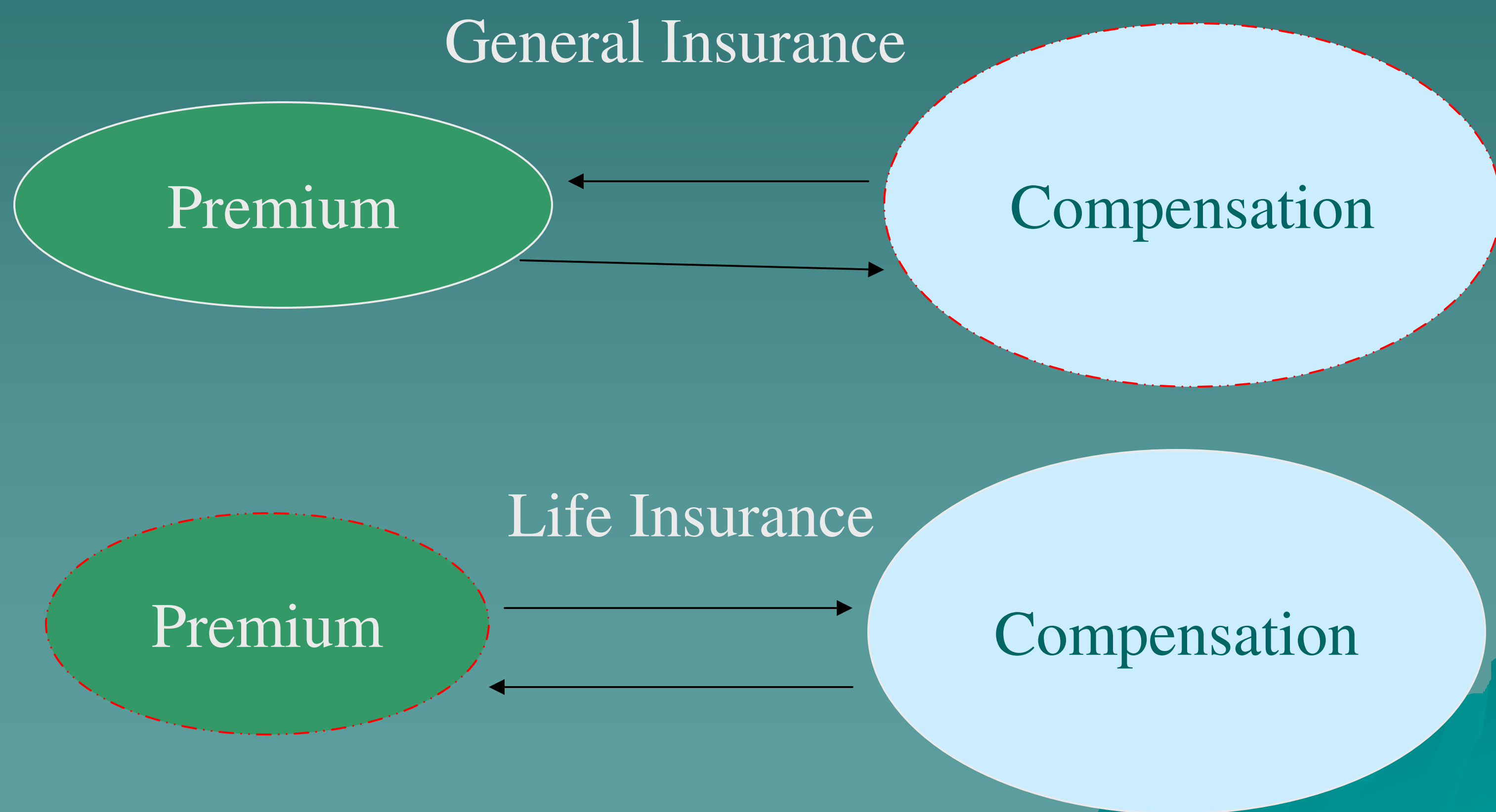
Definition of Insurance

Insurance is an economic device whereby the individual substitutes a small certain cost (premium) for a large uncertain financial loss (the contingency insured against) that would exist if it were not for the insurance.

Socio-Economic Benefits of Insurance

- Risk Coverage
- Habit of Thrift
- Safe and Profitable Investment
- Secure working environment for Businesses
- Planning for life stage needs
- Capital formation in the Economy

Nature of Insurance Contract



Shariah Position of Insurance

Opinion of Shariah scholars is divided on insurance. We can classify them into three major groups.

- **Those who consider both the concept and practice of commercial insurance un-Islamic.**
- **Those who are in agreement with the present insurance and find nothing wrong in it.**
- **Those who accept the concept of insurance, but find prohibited elements in its present practice.**

Rulings of Collective Fiqhi Bodies about Insurance

- Islamic Research Institute of Al-Azhar Uni.
- Council of Grand Ulama of Saudi Arabia
- Majlis Tahqiqat-e-Shari'yah Lucknow, India
- Islamic Fiqh Academy of Rabita al-Aa'lam-e-Islami
- Al Majma' Al-Fiqhi Al- Islami of OIC
- Council of Islamic Ideology, Pakistan

Major Arguments Against Insurance

According to these Fiqhi bodies Conventional Insurance is unlawful because of involvement of prohibited elements like,

- **Riba (Interest)**
- **Qimar (Gambling)**
- **Gharar (Uncertainty, Doubt, Risk)**
- **Unlawful appropriation of others' property**
- **Violation of law of inheritance in case of life insurance.**

Islamic Substitute

- These Fiqhi bodies suggested that that an scheme based on the concept of mutual cooperation and Joint responsibility may be considered as Islamic Substitute for conventional Insurance.

- That alternate is introduced under the title of Takaful in the recent past.

Takaful Pioneers

- **Takaful started some 30 years ago in Sudan and Middle East in 1979 with the establishement of:**
  - **The Islamic Arab Insurance Co. (IAIC) in the UAE and**
  - **The Islamic Insurance Co. of Sudan**
- **But it took some time for the movement to take shape.**

Takaful Pioneers

- **Later in 1984, Malaysia played a pioneering role in setting the first Legal framework specific to Takaful (Takaful Act Malaysia).**

- **This was instrumental in the successful launching of the Takaful movement in Malaysia and in other countries of South East Asia.**

Other Islamic/ Takaful Legislations

- Other markets such as the Sudan and Iran have Islamic regulatory environments and became naturally Takaful markets.
- In Pakistan Takaful Act is enforced in 2005 and Pak-Kauwait Takaful Co. started its operation.
- In the Gulf countries specific Takaful legislations are coming through in Bahrain and in Saudi Arabia

Takaful Today

- **From a handful of operators two decades ago the Takaful movement has blossomed into a fast growing phenomenon in many Muslim countries with very promising prospects in other countries with a large Muslim community.**
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Takaful drivers

This movement is driven by

- **a strong demand from a public who would not insure otherwise (because of religious beliefs); and**
- **The successful development of Islamic banking institutions providing capital and Islamic financial instruments for asset management and investment.**

Takaful Drivers

- Islamic banks and financial institutions play a strategic and important role in the distribution of Takaful products (especially Life Takaful Products).
- Just as Bancassurance played an important role in the distribution of personal lines insurance products Bancatakaful is an important driver for Takaful.

Takaful Operators

The number of Takaful operators worldwide is now estimated at:

- 150 Takaful companies operating in 40 countries
- 10 Retakaful companies
- 6 Islamic windows by Conventional Reinsurance companies

Takaful Premium

- Takaful is one of the fastest growing segments in insurance (at around 20% pa. on average)
- World Takaful contributions are conservatively estimated at around US$ 10 billion, of which:
  - 60% General Takaful
  - 40% Family Takaful

Takaful Geographical Spread

- South& East Asia : 56%
- Middle East : 36%
- Africa: 7%
- Europe, USA & Others: 1%

Definition of Takaful

The word Takaful means joint guarantee. The objective of Takaful is cooperation and mutual help among the members of a defined group.

In a practical sense Takaful can be visualized as a method of joint guarantee among a group of members or participants against loss or damage that may inflict upon any of them. The members of the group agree to guarantee jointly that should any of them suffer a catastrophe or disaster, he would receive certain sum of money to meet the loss or damage. All members of the group pool together their efforts to support the needy.

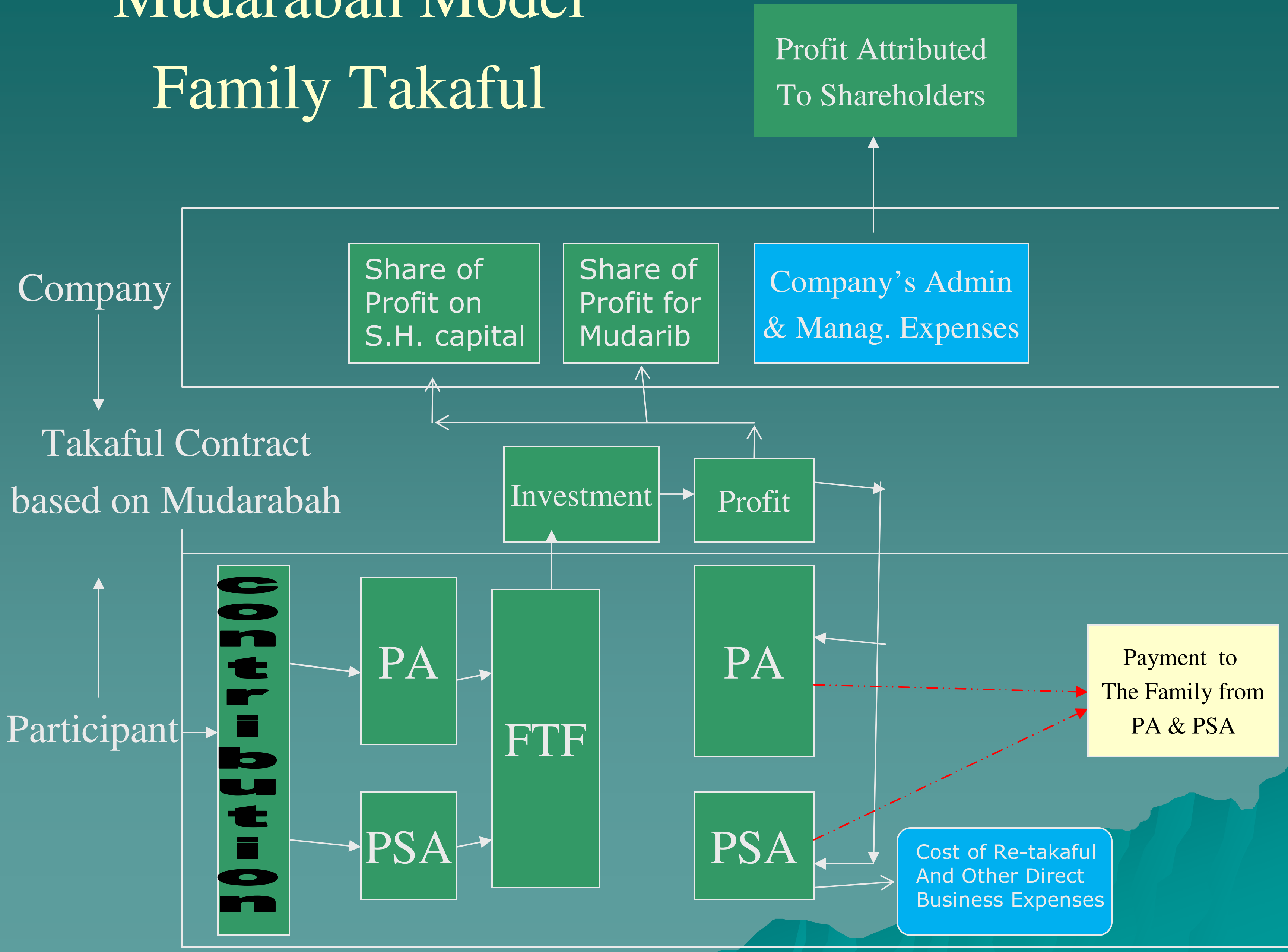
WORKING OF THE TAKAFUL BUSINESS: The Malaysian Case

- Takaful Business is based on the concepts of Mudarabah and Tabarru. Involvement of these two Islamic forms of business eliminates the elements of Riba from insurance contract and convert Gharar into tolerable form.

- In Family Takaful each Takaful installment is divided and credited into two separate Accounts namely, the Participants' Account(PA) and the Participants’ Special Account(PSA). A substantial proportion of the installments is credited into the PA solely for the purpose of savings and investment.

- The balance of the installments is credited into the PSA as `tabarru' for Sharikah Takaful Malaysia to pay the Takaful benefits to the heir(s) of any participant who may die before the maturity of the contract.
- The amount accumulated in the PA is invested in various business according to Islamic financing techniques, and the resultant profits are divided between the company and the participants according to the agreed upon ratio, e.g., 30-70.
- The participant's share is calculated according to their individual share in the PA, and credited into their respective accounts, the PA and the PSA.

Mudarabah Model
Family Takaful



Payment of claims

Should the Participant die or suffer Permanent and Total Disability in the fifth year of participation, Takaful benefit will be paid in the following manner:-

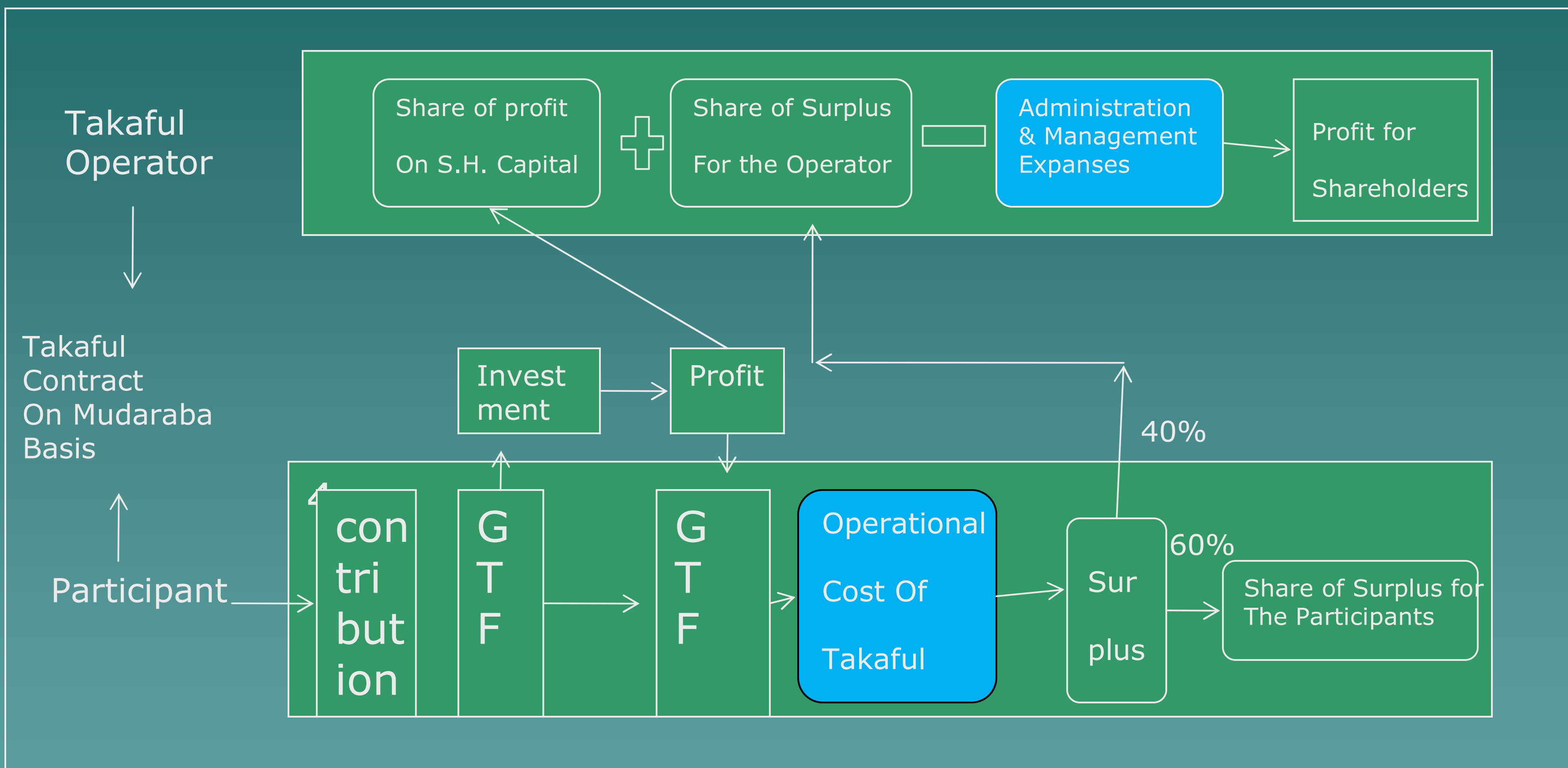
- **i. From Participant's Account =RM 4,890**
  (RM978 x 5)
  profit if any, say RM 400
- **ii. From Participants Special Accounts (RM1000 x 5) RM 5,000**
- **Total Takaful Benefit Payable RM 10,290**

In case the Partcipant survived

Should the Participant survive until the maturity of his FTP, payment of Takaful benefit will be made to him as follows:-

i.	From his Participant's Account = (RM978 x 10)	RM 9,780
	profit from investment	RM 1,800
ii.	From Participants Special Account	RM XXXX
	Total Takaful Benefit =	RM 11,580 + surplus determined by Sharikah Takaful.

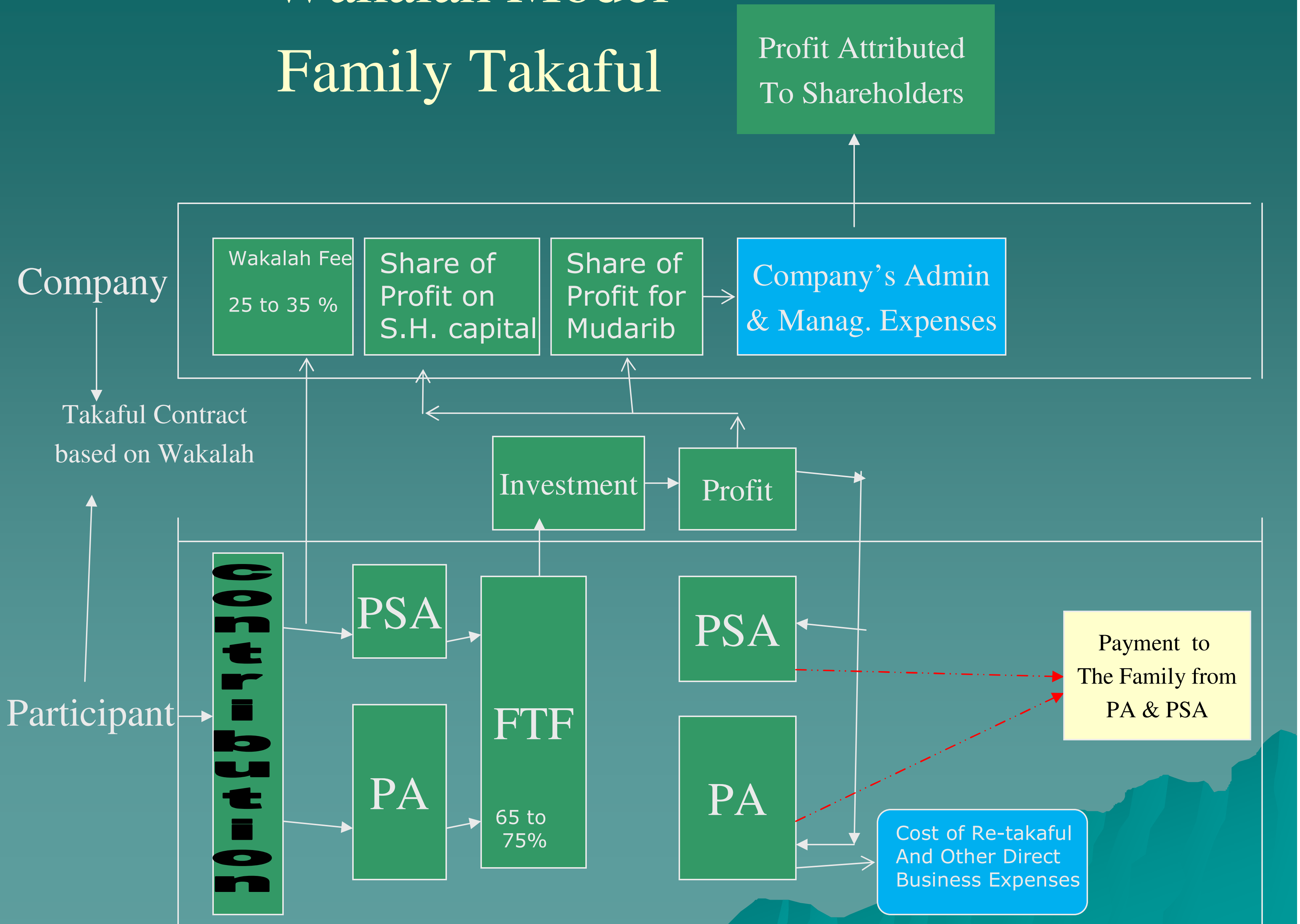
Mudarabah Model
General Takaful



Shariah Concerns regarding Mudaraba Model

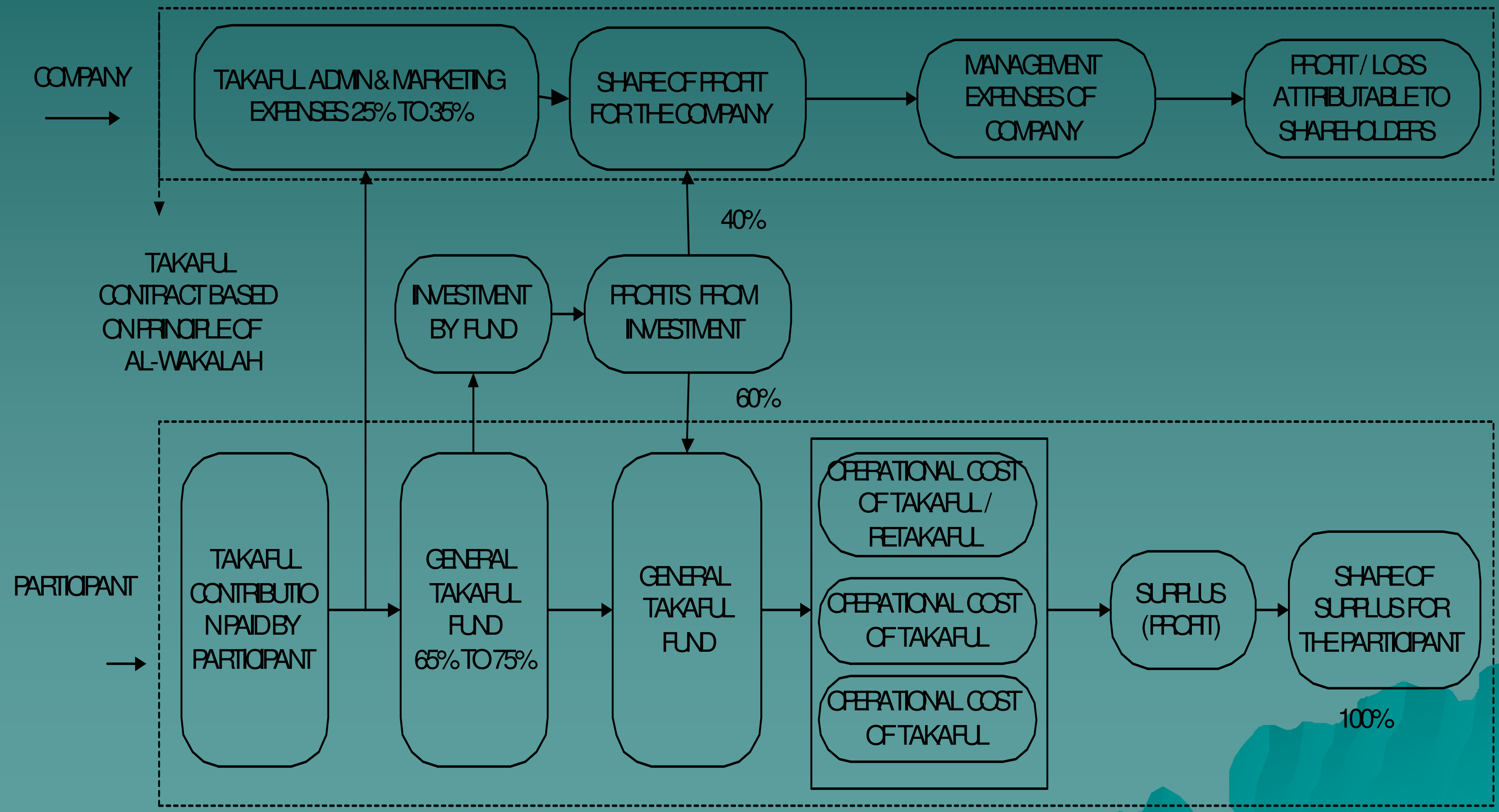
- Mudaraba is a commercial contract, hence not suitable for a donation (Tabarru) based scheme.
- Donation given by the participants can not become capital for Mudaraba at the same time.
- Distribution of surplus among the participants in proportion of their contributions is like a conditional gift(Hiba bis-Sawab) which is not allowed.
- Sharing of surplus in case of General Takaful(instead of profit) makes the contract essentially the same as conventional insurance contract.
- Provision of Qard-e-Hasan from the Share holders fund in case of deficit is not correct as Mudarib is not a guarantor.

Wakalah Model
Family Takaful



Wakalah Model

General Takaful



Shariah Concerns regarding Wakalah Model

- Wakalah model is free from many objections raised against Mudaraba model but some shariah concerns are still there which are as follows:

- Distribution of surplus among the participants in proportion of their contributions is like a conditional gift(Hiba bis-Sawab) which is not allowed.

- Provision of Qard-e-Hasan from the Share holders fund in case of deficit is not correct as Wakeel is not a guarantor.

Waqf Model

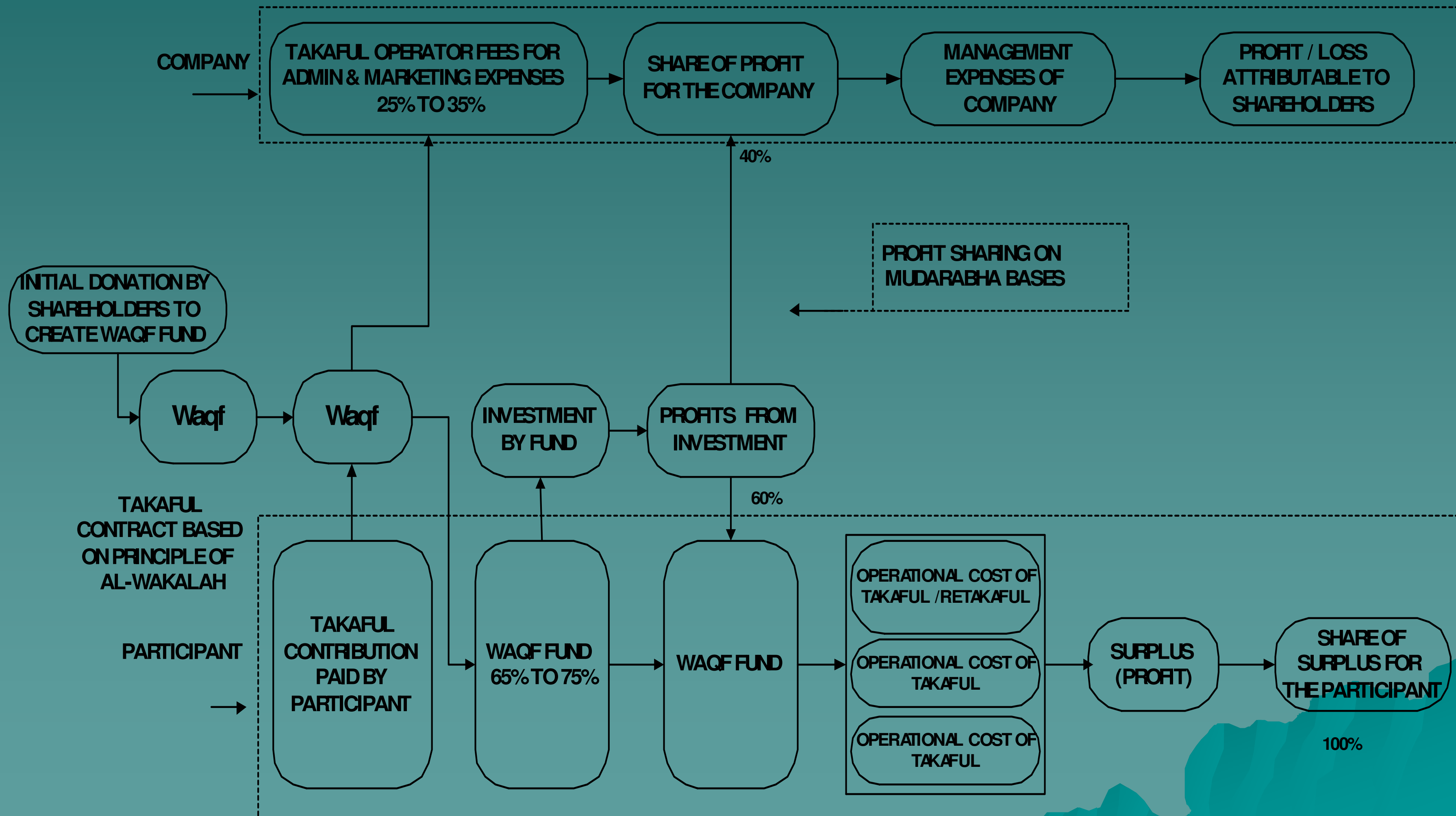
Definition of Waqf

- **Waqf is an Arabic word and it means to stop to withhold and not to let go.**
- **In technical meaning Waqf means to allocate or donate some property or cash for a specific purpose to get pleasure of Allah and not to let it go through consumption or sale.**
- **The Waqf property comes into ownership of Allah (SWT) and Waqif will have no property rights on it.**

Cont…

- Waqif has right to set the rules for waqf and manage the waqf.
- Waqf may be general purpose or specific purpose, like Waqf ‘Ala al Aulad or Waqf ‘Ala al Aqarib.
- In Islamic Law Waqf is a legal entity

Waqf Model


COMPANY
TAKAFUL OPERATOR FEES FOR ADMIN & MARKETING EXPENSES 25% TO 35%
SHARE OF PROFIT FOR THE COMPANY
MANAGEMENT EXPENSES OF COMPANY
PROFIT / LOSS ATTRIBUTABLE TO SHAREHOLDERS
40%
PROFIT SHARING ON MUDARABHA BASES
INITIAL DONATION BY SHAREHOLDERS TO CREATE WAQF FUND
Waqf
Waqf
INVESTMENT BY FUND
PROFITS FROM INVESTMENT
60%
TAKAFUL CONTRACT BASED ON PRINCIPLE OF AL-WAKALAH
PARTICIPANT
TAKAFUL CONTRIBUTION PAID BY PARTICIPANT
WAQF FUND 65% TO 75%
WAQF FUND
OPERATIONAL COST OF TAKAFUL /RETAKAFUL
OPERATIONAL COST OF TAKAFUL
OPERATIONAL COST OF TAKAFUL
SURPLUS (PROFIT)
SHARE OF SURPLUS FOR THE PARTICIPANT
100%

- A Waqf Fund would basically be a separate legal entity to which the Shareholders would initially make a donation to establish the Waqf Fund.
- The donation can be of any reasonable amount (Shariah Board may specify such an amount).
- The objectives of the Waqf fund would be to provide relief to participants against defined losses as per the rules of the Waqf fund.

Cont….

In this modified Wakala Model with Waqf, the relationship of the participants and of the operator is directly with the Waqf fund. The Operator is the Wakeel of the Waqf Fund and the participants pay one sided donation to the WAQF fund (not conditional) which also eliminates the issue of Gharar. The WAQF fund rules may define the sharing of surplus and other rules under which it would operate but there is no obligation to distribute surplus. Further the Qard would be given by the shareholders to the WAQF entity and not to individuals as in the typical Wakalah model.

The Challenges ahead

- Despite a remarkable breakthrough and a dynamic and sustained growth, there are challenges facing the Takaful industry which are:

1) Human Rsources
2) Product Development
3) Distribution
4) Asset Management
5) Re-Takaful
6) Governance & Risk

The business model dilemma

- The existence of three business models:
  - Mudharabah (Profit & Loss sharing)
  - Wakala (agency contract with a performance fee element to replace surplus sharing)
  - Wakala with Waqf model

- Could create an uneven / unfair business environment to operate
- Need to reach a consensus internationally on a common and standard Takaful business model

Future Outlook

Despite the remarkable growth rate recorded by the Takaful industry, penetration is still far below the enormous market potential offered by the Muslim community worldwide (23% of the total world population).

Growth Outlook

- World Muslim population is estimated at 1.5 billions, of which around 97% are based in Asia and Africa.
- A two-digit growth in the range of 15% to 20% can be reasonably sustained for at least the next 10 years in the existing markets (Far and Middle East).

New Takaful Frontiers

- Markets like Europe, North and Latin America, Central Asia, Australia where large Muslim communities live are huge untapped reservoirs;
- The recent opening towards "Islamic windows" in the banking sector in Europe is likely to be followed by "Takaful windows" initiatives.

Takaful Products to Non-Muslims

- Takaful Products are not exclusive to Muslims.
- Competitively priced and sold through the right channel it could attract any consumer irrespective of their origin or faith (e.g. SriLanka).

Conclusions

- Despite the challenges facing this "new" industry, exciting times are ahead once the latent potential is unleashed.
- The success of Takaful largely depends on that of Islamic Financial institutions on a global basis.

Questions & Comments

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