An Introduction to
Takaful – An Alternative to Insurance

By (Muhammad Ayub)*

Islamic finance has developed mainly in two directions namely Islamic banking and Islamic insurance (*Takaful*). While information about Islamic banking is being increasingly disseminated, features, models and structures of Takaful are little known particularly in Pakistan. Purpose of this brief article is to describe main features and models of *Takaful* system operating in various parts of the world.

All human beings are invariably exposed to the possibility of meeting catastrophes and disasters giving rise to misfortunes and sufferings such as death, loss of limbs, accident, destruction of business or wealth, etc. Notwithstanding the belief of all Muslims in *Qadha-o-Qadr,* Islam provides that one must find ways and means to avoid such catastrophes and disasters wherever possible, and to minimize his or his family's financial losses should such events occur. One possible way out is to buy an insurance cover as in the conventional system.

Different views have been expressed about the status of conventional insurance from the point of view of Islam. An overwhelming majority of the Shariah scholars believe that it is unlawful due to involvement of *Riba* (interest), *Maisir* (gambling) and *Gharar* (uncertainty).[@] *Takaful*, the Islamic alternative to insurance, is based on the concept of social solidarity, cooperation and mutual indemnification of losses of members. It is a pact among a group of persons who agree to jointly indemnify the loss or damage that may inflict upon any of them, out of the fund they donate collectively. The *Takaful* contract so agreed usually involves the concepts of *Mudarabah*, *Tabarru´* (to donate for benefit of others) and mutual sharing of losses with the overall objective of eliminating the element of uncertainty.

Takaful is not a new concept in Islamic commercial law. The contemporary jurists acknowledge that the foundation of shared responsibility *or Takaful* was laid down in the system of '*Aaqilah'*, which was an arrangement of mutual help or indemnification customary in some tribes at the time of the Holy Prophet (pbuh). In case of any natural calamity, every body used to contribute something until the loss was indemnified. Similarly, the idea of *Aaqilah* in respect of blood money or any disaster was based on the concept of *Takaful* wherein payments by the whole tribe distributed the financial burden among the entire tribe. Islam accepted this principle of reciprocal compensation and joint responsibility.

The contract of *Takaful* provides solidarity in respect of any tragedy in human life and loss to the business or property. The policyholders (*Takaful* partners) pay subscription to assist and indemnify each other and share the profits earned from business conducted by the Company with the subscribed funds. *Takaful* companies normally divide the contributions into two parts, i.e., donations for meeting mortality liability or

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[@] *Maisir* means any forms of business in which monetary gains come from mere chance, speculation and conjecture and not from work or real sector business. *Gharar* means any major uncertainty about the subject matter or rights & liabilities of parties to the contract.

losses of the fellow policyholders and the other part for investment. Accordingly, the clause of *Tabarru´* is incorporated in the contract. How much of the contribution is meant for mortality liability and how much for investment account is based on a sound technical basis of mortality tables and other actuarial requirements. Both the accounts are invested and returns thereof distributed on *Mudarabah* principle between the participants and the *Takaful* operators. The profit attributable to the participants is credited into the two accounts separately. To describe from another angle, a *Takaful* contract may comprise clauses for either protection or savings/investments or both the benefits of protection as well as savings and investment. The protection part of *Takaful* works on the donation principle according to which individual rights are given up to indemnify the losses reciprocally. In the Savings part, individual rights remain intact under *Mudarabah* principle and the contributions alongwith profit (net of expenses) are paid to the policyholders at the end of policy term or before, if required by him.

The distinction between the conventional insurance and *Takaful* business is more visible with respect to investment of funds. While insurance companies invest their funds in interest-based avenues and without any regard for the concept of *Halal-o-Haram*, *Takaful* companies undertake only Shariah compliant business and the profits are distributed in accordance with the pre-agreed ratios in the *Takaful* Agreement. Likewise they share in any surplus or loss[*] from the pool collectively. *Takaful* system has a built-in mechanism to counter any over-pricing policies of the insurance companies because whatever may be the premium charged, the surplus would normally go back to the participants in proportion to their contributions.

The terms 'Family *Takaful'*, '*Takaful Ta´awani'* or just '*Takaful'* are generally used for family solidarity in place of conventional life insurances. Other products available in various countries are General *Takaful*, Education/Medical *Takaful*, etc. Based on the nature of relationship between the company and the participants, there are various models like *Wakalah* (agency) Model, *Mudarabah* Model and the combination of agency and *Mudarabah* models. In the Sudanese *Takaful* Model that is preferable to majority of the contemporary Shariah experts, every policyholder is also the shareholder of the *Takaful* Company. There is a Board that runs the business on behalf of all the participants and there is no separate entity managing the business. The legal framework in other Islamic countries normally does not allow this arrangement and Takaful companies work as separate entities on the basis of *Mudarabah* (as in Malaysia) and on the basis of Wakalah (as in the Middle East region). In *Mudarabah* model that is practised mainly in the Asia Pacific region, the policyholders get profit on their part of funds only if Takaful Company earns profit. The sharing basis is determined in advance and is a function of the developmental stage and earnings of the Company. The Shariah committee approves the sharing ratio for each year in advance. Most of the expenses are charged to the shareholders.

In *Wakalah* Model, the surplus of policyholders' funds investments – net of the management fee or expenses - goes to the policyholders. The shareholders charge *Wakalah* fee from contributions that covers most of the expenses of business. The fee

[*] Losses, if any, are first absorbed by reserves known as Participants Equity, then from interest free loans from shareholders of Takaful Company and then by a general increase in pricing by the Company.

rate is fixed annually in advance in consultation with Shariah committee of the company. In order to give incentive for good governance, management fee is related to the level of performance.

The Takaful business has proved its viability in a period of only two decades. It has been growing at the rate of 10-20% p.a. compared to the global average growth of insurance 5% p.a. A large number of Takaful Companies exist in the Middle East, Far East, Iran, Turkey, and Sudan and even in some non-Islamic countries. There are over 60 companies offering Takaful services (including Windows- 5%) in 23 countries around the world. Malaysia has developed *Re-Takaful* business as well. *Takaful* products are available to meet the needs of all sectors of the economy, both at individual as well as corporate levels to cater for short and long term financial needs of various groups of the society.

A Convention of D-8 countries was held in Kuala Lumpur in November, 2002 on "The Emergence of Takaful in the Wake of Globalization". It is worth noting that among D-8 countries it is only Pakistan where *Takaful* business has not been introduced so far. Islamic banks and financial institutions require *Takaful* services for their operations. Although, the insurance business in Pakistan falls in the jurisdiction of the Securities & Exchange Commission, Pakistan, institutions operating Islamic banking would have to deal with insurance. As such, the Central Bank should desire that *Takaful* business be introduced in the country at the earliest. In the revised Insurance Act, the Government of Pakistan has added the provisions for *Takaful* companies in the country. As reported in the press, Pak Kuwait Investment Corporation has recently been allowed by the SEC to establish a *Takaful* Company in Pakistan under the name of "First *Takaful* Insurance Company Limited" with authorized capital of Rs 100 million.

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