

TAKAFUL – THE ISLAMIC INSURANCE

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The concern for safety and security is very basic and fundamental to human nature. Insurance evolved arising out of this basic human need. In today's, world one cannot think of trade and commerce without insurance support. On individual level also no financial planning and risk management can be complete without life insurance. The concept of insurance as it evolved initially was more in the nature of an arrangement of mutual help in times of need and distress rather than a business proposition for profit making as practiced today. With very fast technological developments taking place and with growing complexity of business operations and risk profile and the high stakes involved, the insurance sector has to be necessarily very dynamic and responsive in nature. The changing social norms, and expectation of people have their own impact on insurance sector. All indications are that insurance sector will show healthy growth in the days to come.

The concept of insurance and its practice in some form or the other has been there much before Islam came. On the one hand there is a need felt by the educated class amongst the Muslims for insurance and on the other hand is their religious sensitivity and belief. This section therefore looks towards ulema's (Islamic Religious Scholar) for guidance. Hence of late one often comes across "FATWAS" (Religious Decree) being issued declaring insurance as un-Islamic, though these mostly relate to life insurance. The insurance need for the Muslim remains, nevertheless. What is the way out? Why insurance is viewed un-Islamic? What could be the other possible alternatives? These are some of the questions which need answers.

Islam preaches true brotherhood and wants a just social order to develop free of exploitation of any kind. It is a social order with complete code of life with guidance for worldly activities also. The Islamic economic system is modeled on

Quranic injunctions, sayings and tradition of the prophet of Islam. Banking and Insurance are the two most important pillars of any economic system. While Islamic banking has now been there for quite sometime and is well known, the information about Islamic Insurance needs to be disseminated.

Objections are raised by ulema's against the present practice of the transactions of insurance business because of the presence of the following elements which are considered un-Islamic and hence forbidden in Islam.

- 1) Riba i.e. interest: The term Riba means an increase, or an addition or excess. In conventional term "interest" is the equivalent of Riba. In a loan transaction it denotes any increase or advantage obtained by lender as a condition of loan. Riba in any form is totally forbidden in Islam by a very clear Quranic injunction. This fact is accepted by ulema's, of all schools of thought. The institution of Riba (i.e. interest) leads to the development of undesirable / unhealthy traits (selfishness, miserliness, greed, exploitation) at the individual level and at society level it affects the cohesiveness and harmony of the society. In the traditional life and general insurance policies the element of Riba is present.
 - In life insurance because at the time of claim (death / maturity) the amount payable under the policy is much more than the amount received by way of premium
 - In general insurance, the insurance funds are invested in instruments which are interest based. This applies to life insurance also.
- 2) Maisir i.e. gambling: The gambling, again, is un-Islamic and prohibited by Quranic injunction. Gambling gains are nothing but unearned gains and it is accepted by everyone, both Muslims and non-Muslims, that the impact of gambling is very harmful for the

individual and society. The element of gambling is believed to be there in the conventional insurance policy for the following reasons.

- In general insurance, if there is no claim, the policy holder loses the premium paid. Besides the premium paid is very less compared to the likely claims benefit. There may be situations where the insurance company will end up in deficit if the claims amounts are higher than contributions
- In life insurance, the contract amounts to a wager on the policyholder's death. Besides, the policyholder if he is not able to sustain the payment of premium stands to lose. However, there is a thinking that in view of calculation of human life value in life insurance policies it can not be treated as wager.

Maisir means any form of business in which monetary gains come from mere chance, speculation and conjuncture and not from work or real business. In that sense life / general insurance contracts conform to Maisir.

3) Gharar i.e. uncertainty: any form of contract which is lop sided in favour of one party at the expense and unjust loss to the other is classified as gharar and is considered to be un-Islamic. The element of gharar is there in conventional insurance contract because of the following reasons:

- Uncertainty involved, as the benefits are dependent on the outcome of future events, which are not known at the time of signing of insurance contract.
- Unjust because of the forfeiture of premium paid in case of lapse of insurance in life insurance contract and the so called short period scale used in refund of premium in general insurance.

Gharar means any major uncertainty about the subject matter or rights and liabilities of the parties to the contract and for obvious reason this is not desirable.

In view of the above, unless every aspect of an insurance practice complies with Shariah requirements, it will be considered to be un-Islamic. Therefore there was a need to develop an alternative insurance system which is based on Shariah principle and is ethical in its approach. The traditional insurer seeks to benefit (may exploit) the policyholder's fear of potential future misfortune. This is viewed by many as inappropriate way of making money.

There is substantial Muslim population all over the world and because of the Islamic revivalism effort the need for Shariah based insurance has become all the more acute and there is therefore huge business potential also to tap. The response to this need has come in the form of what is called "Takaful Insurance." Takaful is an Arabic word which means "guaranteeing each other" or joint guarantee as against guarantee or mutual security. Takaful or Islamic Insurance is basically based on the concept of mutual or cooperative insurance and it takes care of all the Shariah related concerns including ensuring investment to be made in Shariah compliant instruments. The concept of Takaful as such is not new in Islamic Commercial Law. Islam accepts the principle of reciprocal compensation and joint responsibility. The system of Takaful insurance tends to achieve self-reliance through a self-sustaining insurance system based on community pooling, solidarity and joint guarantee for the well being of community and individuals in need, the entire system and operation being based on Islamic principle.

The policyholders (Takaful partners) pay subscription to assist and indemnify each other and share the profits. The profit is earned from

business conducted with the subscribed fund. There are two important modules under Takaful which are based on accepted financing practice permitted in Islam.

- 1) Modarbah
- 2) Wakalah

Modarbah: Translated in English it would mean as profit and loss sharing. This is a form of business contract in which one party brings capital and the other personal effort and the required skill. The proportionate share in profit is determined in advance by mutual agreement. But the loss, if any, is to be borne by the provider of the capital and in that case the manager (entrepreneur) gets nothing for his efforts and thus lose the reward for the efforts made and skill provided. This model is used in Malaysia.

- 4) Wakalah: Here the Takaful provider act as an agent for the participants and manages the Takaful / Retakaful (Reinsurance) fund for a fee. This model is generally used in middle-east region. Whether the Takaful is organized on wakalah or modarbah model, its distinguishing features are as under:-

- 1) The policyholders are the participants to the Takaful / Retakaful fund
- 2) The contribution so received are not aimed at making profit per se but are more in the nature of pooling the risk and risk management rather than risk taking.
- 3) The Takaful operator is not the owner of the fund but merely its custodian.
- 4) The surplus generated belongs to the contributor (i.e. policyholders) solely under wakalah model and to both i.e. policyholder and Takaful Company under modarbah model. This is a unique feature of Takaful insurance

- 5) Since the surplus would go back to the participants in proportion to their contribution, there is an inbuilt check on over-pricing
- 6) Funds are invested in Shariah compliant instruments / avenues. Incidentally, Reliance Life has come out with a plan called RSIP where the investment is made in non-banking sector excluding liquor, cigarette, tobacco, entertainment, gambling, etc.

As in traditional insurance business which is organized on life and general insurance sectors, the Takaful insurance is also organized on “Family Takaful” - similar to life insurance and general Takaful – similar to general insurance business, with reinsurance support being provided by Retakaful Company. It will not be out of place here to mention that GIC Re which is eyeing the lucrative potential of Retakaful business, is all sets to go for the same.

The potential for Takaful insurance and various Takaful products is quite huge and substantial. The following factors will further propel this growth in the days to come.

1. Islam is the fastest growing religion and the Muslims constitute the second largest religious group in the world. There is now a greater tendency amongst the Muslim population worldwide to go in for religion based solution to problems they face, be it social economic or others.
2. Insurance penetration in Muslim countries is very low. The same applies to the Muslim population in other non-Muslim countries. One reason is the un-Islamic character of present day insurance system. Any alternative system, which can provide religious comfort to Muslim, therefore has tremendous potential.
3. Takaful insurance is seen as more ethical, more balanced for all the stakeholders and less exploitative in nature. It is fairer and more transparent system. In the traditional insurance the premium paid becomes dead expenditure without any corresponding benefit if there is

no claim. In view of the uniqueness of Takaful system, it has the potential to become very popular with non-Muslim population also. Policyholders under this system know up front the formula and mechanism for profits sharing. Profit sharing is a great attraction.

Takaful business is viable and has been there for more than two decades now. Takaful products are available to meet the needs of all sectors of economy at corporate and individual level. There are Takaful exclusive insurance companies operating in many countries and there are traditional insurance companies operating with “Takaful Window.” There are now Retakaful providers also. Malaysia was the first country to come out with Takaful Act 1984 modeled after traditional existing insurance Act. This act provides for the procedure for registration of Takaful providers and establishes the conditions under which they will operate. It requires the operator to establish a Shariah Committee to monitor and certify Shariah Compliance. It is a comprehensive legislation covering the entire gamut of operation of a Takaful company. In 2005, Pakistan introduced very detailed rules governing Takaful-incorporating experiences learnt from other jurisdiction. In some other Islamic countries also there is a move to develop regulatory norms for Takaful. Recently, even a small country like Sri Lanka has introduced certain Takaful products.

As far as India is concerned, though there is great potential for Takaful in view of substantial Muslim population and also keeping in mind the uniqueness of Takaful insurance which makes it attractive to non-Muslims also it (Takaful) has not come to India as yet. GIC is thinking of going in for Retakaful. It is only a matter of time when Takaful will take root in India. As observed above, seeing the huge potential Reliance Life has come out with plans where investment of funds is made in Shariah compliant mode. Though this is not a Takaful product per se, it is indicative of the shape of the things come in future. IRDA

should think in terms of developing the required regulatory framework for Takaful insurance. The challenge of penetration of Insurance in India can be partly addressed through this system. But responsibility also lies with the Muslim community in India, specially the educated class to take initiative to develop a class of people who are not only well-versed with Islamic teachings, Quranic injunction, sayings and traditions of prophet of Islam but also have sound knowledge of modern day economic principle and practices. Unless there are qualified and competent people with proper understanding and insight into the Islamic Shariah and the way the modern economies are run, it will be difficult to constitute Shariah board to supervise and certify Takaful. This is a basic requirement if Takaful is to take root in India.

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