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# Revisiting Takaful Insurance: A Survey on Functions and Dominant Models

Hashem Abdullah AlNemer*

**Abstract**

*Takaful is a growing and fast-developing industry, which offers an insurance policy that complies with Islamic law. Such business is highly recommended by most Muslim scholars because it reflects the real meaning of brotherhood in protecting individual and corporate bodies against loss or hazards to themselves and their properties. As a result, a number of operational models have been applied by takaful operators[1] by adopting one or more contracts, such as Mudarabah, wakalah or waqf. This paper will therefore highlight important issues that deal with the background of Islamic insurance in terms of definition, functions, as well as exploring takaful contract constructions and various mechanisms linking the contract parties. Finally, this paper will highlight the most dominant and practiced models used by takaful operators worldwide.*

**Keywords:** *definitions, Functions, contract mechanisms, models.*

## Introduction

*Takaful* is the Islamic counterpart of conventional insurance. *Takaful* premiums have reported a gradual, yet increasingly high rate of growth. The global *takaful* market was estimated to be at a level of over U.S. $ 2.1bn of premiums for 2002. By 2008 the estimated size of the global *takaful* premium was US $ 5.3bn and to reach US $ 8.9bn in 2010 (Bhatty, 2010). This was expected to rise to a figure of US $ 12.5bn by 2015 (Lewis *et al.*,

* Lecturer in Finance, King Abdulaziz University Jeddah, Saudi Arabia; Email: dr.hashem.alnemer@gmail.com

2007). Interestingly, this figure for 2015 was revised from an earlier similar estimate of $7.5 billion made in 1999, which to a great extent indicates that business expectations may have been materializing at a faster pace than initially anticipated, driven largely by strong market growth in the Gulf region and in particular Malaysia (Abdul Wahab *et al.*, 2007). There were some 179 *takaful* companies and windows (20%) in 2008, and the number of such enterprises in 2010 can easily be said to be in excess of 200. The total capital committed within the *takaful* industry in 2007 was around US$ 3.5bn (Bhatty, 2010). Saudi Arabia remains the largest *takaful* market in the GCC with contributions of US$ 2.9 bn in 2008 (E & Y, 2010).

The high growth rate of *Takaful* is strongly based on the unique characteristics of the *takaful* business contract, which differ from commercial insurance business, in that the latter are based on sale and purchase of policy or protection cover in return for a premium payment, and all associated premiums and any investment return profit or underwriting surplus arising from the policyholders collected pools will be automatically directed to the insurance company fund. However, in case of the *takaful* business, the premium payment by the participants[2] is considered as a donation contribution or *"tabarru"*, which is paid for the purpose of brotherhood or mutual indemnity among all participants. The *Takaful*- operated company is considered as an agent to manage the fund contributed to by participants with their full consent. Thus, a clear segregation between the shareholders' and participants' fund(s) is one of the principles on which the *takaful* business is constructed, which satisfies the compliance requirements of the *Sharia'h*[3] compliance requirements. Accordingly, *takaful* business will have different operating models and contractual terms, concept and mechanisms than conventional insurance systems.

## Definition of *Takaful*

*Takaful* is derived from the Arabic root word *"kafala"*, a verb which means guarantee, bail, warrant or an act of securing one's need (Engku *et al.*, 2008).

*Takaful* is also defined in Section 2 of the Malaysian Takaful Act 1984 as;

"A 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."

AAOIFI's[4], also defined Islamic insurance on (2004/2005) as per the Financial Accounting Standard No. 12, in Appendix E;

"Islamic insurance is a system through which the participants donate[5] part or all of their contributions which are used to pay claims for damages suffered by some of the participants. The company's role is restricted to managing the insurance operations and investing the insurance contributions."

By 2007 AAOIFI defined Islamic insurance as being in line with *shari'ah* Standard 26 (2) 2007;

"Islamic insurance is an agreement between persons who are exposed to risks to protect themselves against harm arising from risk by paying contributions on the basis of a "commitment to donate". Following from that (principle) the insurance fund is established and is treated as a separate legal entity which has independent financial liability. The fund will cover compensation against harms that befall any of the participants due to the occurrence of the insured risks (perils) in accordance with the terms of the policy."

## Functions of *Takaful*

It may be thought at first glance that *takaful* does not deviate from conventional insurance, since both types depend on the concept of pooling money from a group for the sake of helping the unfortunate of the same group in the event of encountering financial loss. However, unlike *takaful*, spiritual mutual support is not a requisite of commercial insurance. Commercial insurance is based on a form of exchange whereby the insured pays a premium in exchange for protection in case of calamity exposure, with "no compensation"[6] in a case of no loss. However, the *takaful* mechanism is based on the concept of *tabarru* (donation)[7] combined with the intention (*niah*) to participate in the pooling aid mechanisms. Hence, those who participate in the *takaful* mechanism will be less likely to encounter the feeling of receiving nothing if no claim occurs. They will feel sufficiently satisfied to help their colleague in the same pooling group in the loss he incurs.

Another unique function of Islamic insurance is the strong relationship between *takaful* operator and participants, in that the *takaful* operator will go even beyond the provisions of "the needs of spiritual satisfaction"[8], by providing nobel services which will be rewarded by God only such as the following benefits for the deceased's family upon the participant's death.

(i) To properly distribute the deceased's estate upon his/her death.
(ii) To calculate and distribute *Zakah o*n behalf of all participants.
(iii) To mandate others to perform Hajj on behalf of the participant upon his/her death.
(iv) To make arrangements for "*Sadaqah Jariah*"[9] (Nordin, 2007).

The conventional method of satisfying a customer is realised by fulfilling their material or worldly needs with benefits such as low prices, higher returns, faster delivery or even benefiting the deceased's family members after his death in the form of life insurance. However, this does not mean that customer satisfaction in terms of price, quality, delivery and precision are not important to the *takaful* operator; in fact they remain important while the satisfaction of the customer's spiritual needs are also met. So when Muslims buy Islamic insurance they can combine two benefits; (i) They receive Islamic protection that complies with *Shari'ah* rules against financial loss, in the same way as conventional insurance guaranrtees, as well as (ii) distancing themselves from the possibility of sin[10] incurred by purchasing conventional insurance.

Finally, although a believing Muslim is required to accept destiny, which may incorporate certain misfortunes, Islam encourages Muslims to take extra precaution to minimize potential misfortune, losses or injury arising from unfortunate events. Thus, having an insurance policy is not considered to be against the will of Allah, rather the will of Allah can be enhanced by holding an insurance policy to offset (?) the unexpected risk that exists in day to day life. (Al-Zarqa, 1962; Attar, 1983).

## *Takaful* Contract

The majority viewpoint held by contemporary Islamic scholars is that *takaful* contract is fully consistent with *Shari'ah* principles (Fisher *et al.*, 2000; Al-Salih, 2004). Akin to English law dealing with contracts, Islamic Law has established fundamentals which are required in an insurance policy, such as "parties to the contract, legal capacities of the parties, offer and acceptance, consideration, subject matter, insurable interest and utmost good faith" (Dacey, 1989). The presence of certain elements and the absence of others can make a difference between a valid or void contract in the eyes of *the Shari'ah*.

As for the mechanisms of the *takaful* contract, There are four parties involved in a *takaful* contract, namely: the participant[11], operator[12], insured person, and beneficiary[13]. Hence, cooperation among these parties creates four mechanisms in the *takaful* scheme.

(i) Contract between participant and fund
The money belonging to the participant is transferred to the fund. In current practice, the fund is based on the principle of *tabarru*. In case of loss risk, the participant ,as is also the case with the members of the fund, can receive benefit by the cover that the fund provides. Thus, the money belonging to the fund is transferred[14] to the participant. The current *takaful* practices are based on "commitment to *tabarru*"[15], *i.e.* the *takaful* operator as the agent of all participants can claim a premium from participants, because the ownership has been transferred when the agreement was signed. However, if the contract is based on (pure *tabarru)* then the *takaful* operator cannot make demands to the participant to pay the premium, because the ownership was absolutely transferred when the participant delivered his premium and delivery did not occur when the agreement was signed.[16]

(ii) Contract between company and participant
The relationship here is not as insurer-insured rather than of a participants-operator one; the participants insure themselves, while the *takaful* operator is engaged by the participants to manage the *takaful* scheme on behalf of them (Engku *et al.*, 2008). The participant in a *takaful* contract is considered to be a *muwakkil* (principal) and the company as a *wakil* (agent) to manage the participant's money. The

duties of the company as a *wakil* or agent of the participant, is to manage the fund in terms of a contractual arrangement, and to undertake all administrative matters, underwriting activities and technical issues, as well as to manage the investment portfolio of the fund. Depending on the type of the underlying contract, the *takaful* operator may receive a fee, or share the profit on investments as a reward for managing the *takaful* scheme. The *takaful* company and the participant will enter into a long-term *takaful* contract, whereby the contract spells out clearly the rights and obligations of the parties to the contract. The participants are then required to pay the *takaful* instalments on a regular basis. In return for participation in the *takaful* plan, the customer decides the amount of *takaful* instalments that he/she wishes to pay subject to the company minimum sum at the time of signing the contract. (Hassan *et al.*, 2007)

(iii) Contract between company and fund:
The relationship here is to be regarded as a contract to invest the participant's money; the money belonging to the fund is transferred to the company, acting as a *wakil*[17] or as *mudharib*[18]. The *mudharib* will invest the general *takaful* fund in line with *Shari'a*h principles and all returns on the investment will be pooled back into the fund. On the other hand, the participants agree that the company shall pay from the general *takaful* fund, compensation or indemnity to fellow participants who have suffered a defined loss. The fund shall also pay for other operational costs of general *takaful* business such as re-*takaful* arrangements and the setting up of technical reserves (Tolefat, 2008).

(iv) Contract of the participant's mutual assistant:
Under this system, participants mutually and voluntarily agree to contribute money to support a common goal of providing mutual financial aid to members of the group in case of specific need[19], this system is based on "mutual protection and solidarity"[20]; the participants should embody certain "principles and beliefs"[21] when dealing with each other (Ali, 2006).

On the other hand, everyone is allowed to buy a *takaful* policy whether Muslim or not. In fact, in Malaysia, non-Muslims make up the largest portion of *takaful* policy- purchasers by 2007 with a share of 60% (Bhatty, 2008). However not everyone is allowed to sell *takaful* policy.

## Types & Models Of *Takaful* Contract

The *takaful* products are available in two forms: *general*[22] and *family*[23]; the product shelf of the general *takaful agreement* is more comprehensive than that of the family *takaful* . The global average market-share figures for *mix-life* and general *takaful* were 30% life to 70% non-life by 2007. However there are some reasons that lead family *takaful* to lag behind general *takaful* (Bhatty, 2008).

(i) Religious concerns;
(ii) Life insurance appeared to be more as a wager on life, since it has intangible benefits.
(iii) Islamic investment tools were short term in nature and very limited.
(iv) The need for well-educated and talented people to handle general *takaful* products.

Sudan was the first nation to introduce family *takaful* followed by Europe and Malaysia in early 1980, and Qatar and Bahrain in 2001 and 2002 respectively. The Arab countries are more focused on the group family *takaful.* Malaysia, Singapore, and Indonesia are offering several plans[24] for family *takaful*. In contrast, General[25] *takaful* started first in Sudan in 1979 and had then were created for the Middle East markets by early 1980s including: the UAE in 1980, Saudi Arabia in 1983, Bahrain in 1989 and Qatar in 1995, driven by the boost in economic development as a result of high oil prices.

On the other hand, there are several *takaful* operational models that have been adopted by *takaful* operator companies world-wide such as *mudarabah*, *wakalah*, *waqf*, hybrids of *mudarabah* and *wakalah*, *ta'awuni* and non-profit funds. However the first two models are most dominant, due to the fact that the *mudarabah* is widely used in Asia, while *wakalah* has become popular in the Middle East (Smith, 2007).

### Basic *Wakalah* Model

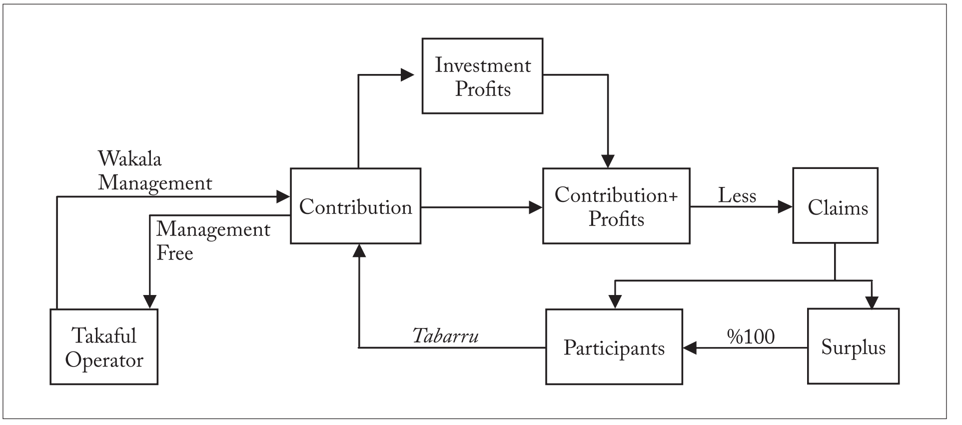
#### *General takaful*

There will be separate contracts in the *wakalah* model, of which one is used for underwriting and the other is used for the investment activities of *takaful* funds. Although the *wakalah* model has been widely practised by *takaful* operator companies in underwriting activities, it is rarely adopted for investment activities (Tolefat, 2008). In the *wakalah* model the participants place their contribution into a pool of donation (*tabarru*), hence the *wakalah* operator, is entitled to a fee (*wakalah* fee), for their effort to manage the *takaful* fund regardless of the performance of the pool. It is an (upfront fee)[26] which is calculated based on an agreed percentage of the total fund. The *wakalah* fee should be approved by the *sharia'h* supervisory board (SSB)[27]. Thereby, most of the operators will declare their *wakalah* fee at the beginning of the contract, but the 'loading' will be calculated at the end of the year once the actual encountered expenses have been declared according to an accurate fee calculation. The *wakalah* fee should be directed to the shareholders' fund as an income for the operator. After that action is conducted, the operator manages the fund by complying with the following procedural steps.

(i) All "direct expenses"[28] are deducted from the remaining fund.
(ii) "Indirect expenses"[29] are paid by the operator only if there is a surplus in the *takaful* fund that has been shared between the operator and the participants, otherwise it will be paid from the *takaful* fund (Lewis, 2003).
(iii) Participants will give the right to the ope tor to invest their funds for an operator investment fee[30].
(iv) The *takaful* fund at this stage represents the income generated from investments after deduction of the management fee for the operator with the underwriting surplus added. The combination of both of these amounts represents the total surplus in the *takaful* fund.
(v) The operator takes part of the surplus as a reserve to strengthen the position of the *takaful* fund.
(vi) The remaining surplus in the *takaful* fund is solely owned by the participants[31] and the operator has no right over this fund as per AAOIFI[32].

As a result, the *takaful* operator has three sources of income (i) the *wakalah* fee from underwriting activities, (ii) the fund investment fee and (iii) investments on the operator's own capital.

**Figure 1:** Basic *Wakalah* Model for General Operational

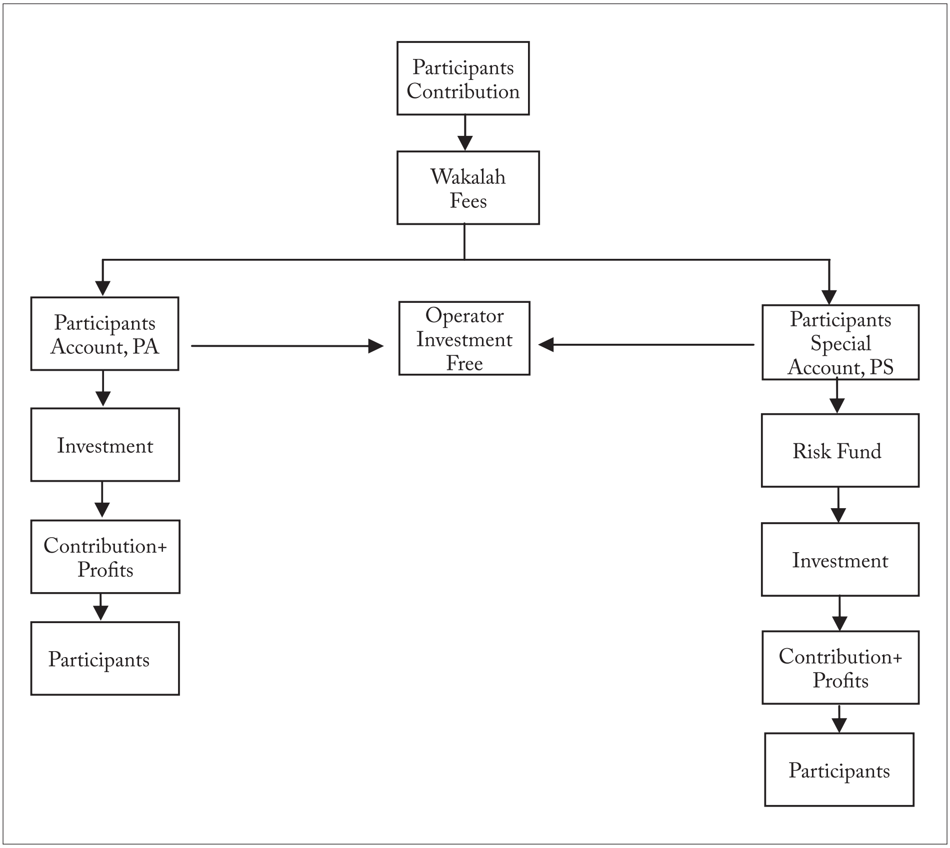



**Source:** Engku et al. (2008, 53); IFSB (2009, 28)

***Family takaful***

Like the general *wakalah* model, the model here used for underwriting and investment activities, the model here can be deviated according to the nature and sensitivity of the underwriting policy encountered (Tolefat, 2008). For example, if the policy concerns (i) risk protection from death, then the contribution splits into two channels. The first contribution goes to the *wakalah* "Agent", for their management effort and other fees related to the family policy "if any", while the second contribution goes to the Participants' Special Account "PSA", in the form of donations[33] (*tabarru*) to participate in the risk of death protection pooling. On the other hand, if the policy is written as (ii) a Family *Takaful* savings policy, then the contributions are split into three channels. The first two channels follow the aforementioned policy. However, a small portion this time goes to the PSA to cover mortality risk, while a substantial portion goes to the Participants' Account "PA" for the purpose of savings and investments. Furthermore, the PSA, and shareholders fund operate in the same way as the *takaful* operates in general. While the PA represents the savings policies, most of the investments here are accomplished on a long term basis, thereby the *takaful* operator deserves a management fee which is calculated as a percentage of the total invested assets, and this fee represents their effort to manage such an investment fund. The *takaful* operator as a result has four sources of income; (i) *the wakalah* fee from underwriting activities, (ii) a fund investment fee from the PSA, (iii) a fund investment fee from the PA and (iv) an incentive performance fee if allowed per the operation procedures.

**Figure 2:** Basic *Wakalah* Model for Family Operational



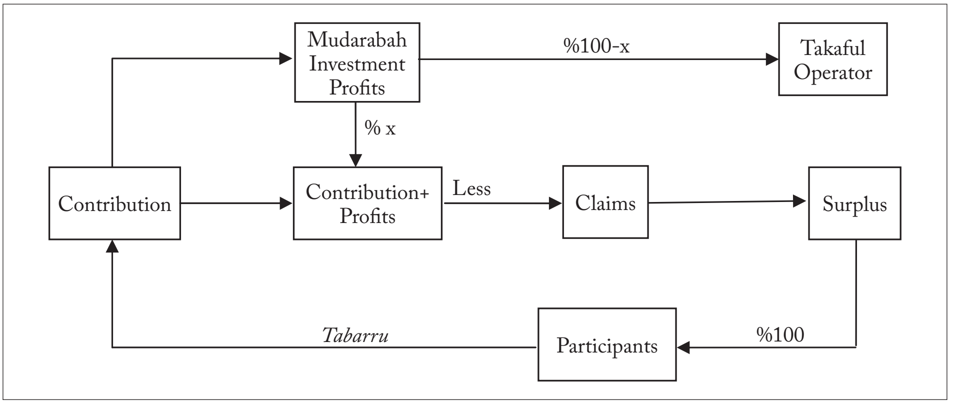

**Source:** IFSB (2009: 28)

## Basic *Mudarabah* Model

### *General takaful*

The contract under the *mudarabah* model will involve profit sharing between the investor[34] (*rabb al-mal*) and the fund manager (*mudarib*), according to a predetermined ratio. In the classical contract there is no fixed return for investors as profit is undetermined and the operator or the *mudarib* has full control, *i.e. rabb al-mal* cannot participate in the ordinary course of business conducted by the *mudarib*. However the *mudarabah* investments are considered a side activity to optimize the use of funds until claims are made or other expenses are incurred (Engku *et al.*, 2008). There is only one contract to cover both underwriting and investment activities, the contract scheme usually operates on the basis of one-year participation. There will also be no upfront management fee or investment fee to be taken out of the contribution toward the shareholder's fund as in the *wakalah* model, however other expenses such as claims, re-*takaful* arrangement and direct expenses are deducted directly from the *takaful* fund that was paid by the participants, while other indirect expenses such as salaries and rent will be paid from the shareholder's fund (Hassan *et al.*, 2007). Furthermore, the operator and the participant's only share direct investment income in accordance with a mutually agreed *mudarabah* profit share, while the underwriting surplus after deduction of all claims and reserves should not in principle be shared with the operator because they are not a *mudarabah* investment profit, but instead a residue of the *takaful* fund (Engku *et al.*, 2008). The *Takaful* operator as a result has two sources of income: (i) profit share in the investment activity surplus and (ii) profit on their capital investment activities.

**Figure 3:** Basic *Mudarabah* Model for General Operational

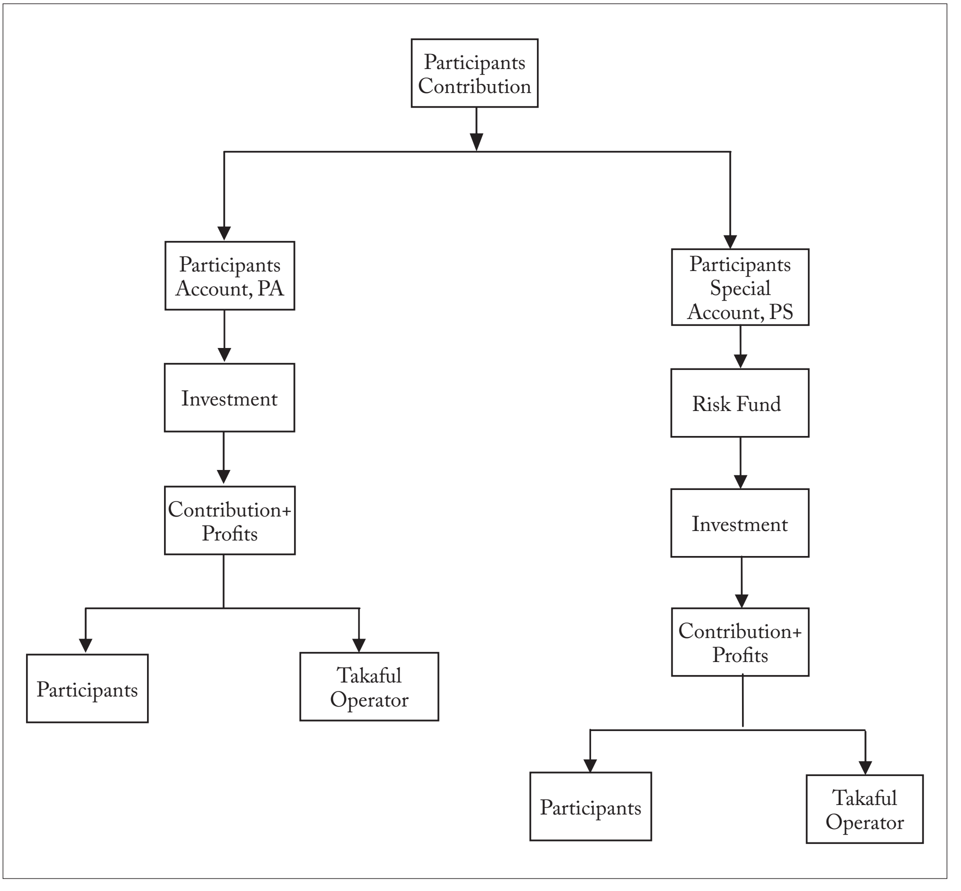



**Source:** IFSB (2009: 28)

***Family takaful***

The operator scheme here follows the same operation channels as those of the shareholder's fund and the PSA that were adhered to in the *wakalah* family model. However, since the PA contains only a saving element of family *takaful*, then the operator share profits are generated from the investment activities of the PA. The *Takaful* operator as a result has two sources of income; (i) the profit share from investment activities for PSA and (ii) the profit share from the asset investment under PA.

**Figure 4:** Basic *Mudarabah* Model for Family Operational



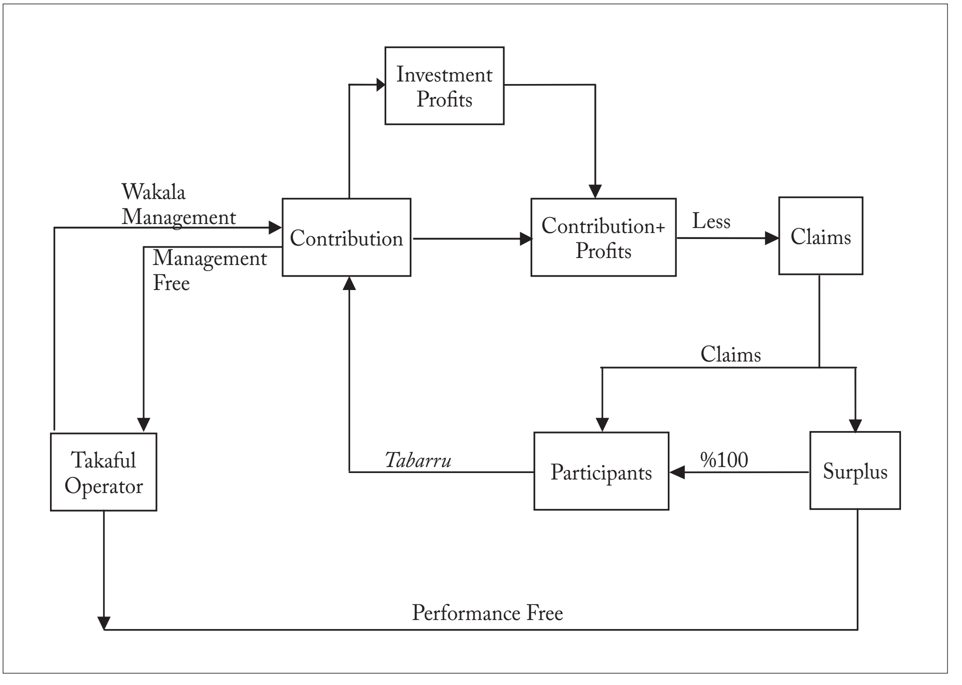

**Source:** IFSB (2009: 28)

## Modified *Wakalah & Mudarabah* Model

### *Modified wakalah model*

The modified *wakalah* model follows the same operational concept as in the (basic) general *wakalah* model. However, as the operator here will share in the "net underwriting surplus"[35] of the participants' fund, such an act should be conducted only with the full consent of the participants (Engku *et al.*, 2008; Asaria, 2009). The *Takaful* operator as a result has four sources of income: (i) a *wakalah* fee from underwriting activities, (ii) a fund investment fee, (iii) investments on the operator's own capital and (iv) an incentive performance fee, *i.e.* sharing in the net underwriting surplus of the *takaful* fund.

**Figure 5:** Modified *Wakalah* Model Operational



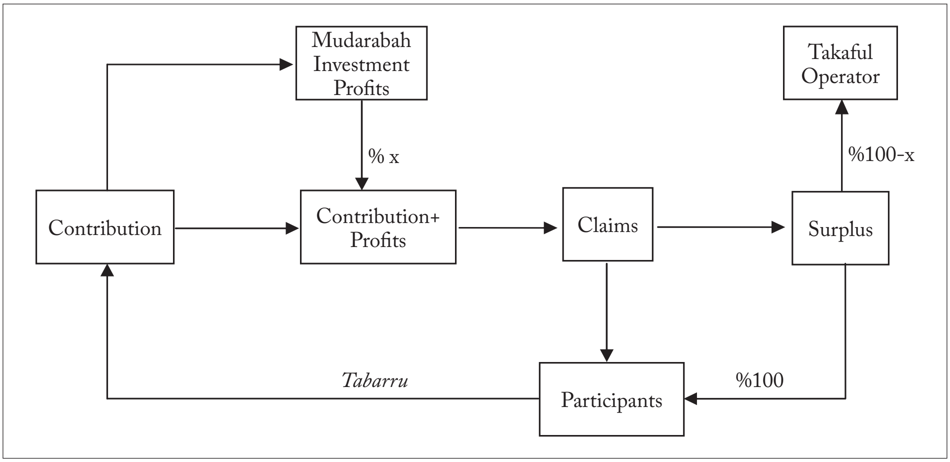

**Source:** Asaria (2009:11)

***Modified Mudarabah model***

The modified *mudarabah* model follows the same operational concept of the basic *mudarabah* model. However the operator will share in the "net underwriting surplus", while the investment income is ploughed back into the *takaful* fund, *i.e.* the operator will not share with the participants in any profit arising from the *mudarabah* investment (Engku *et al.*, 2008; Asaria, 2009).

The profits are defined as the 'positive difference' (or surplus) between the balance of the *takaful* fund at the end of the *mudarabah* contract and the balance of the *takaful* fund at the beginning of the *mudarabah* contract, *i.e.* the operator treats the 'net underwriting surplus' as *mudarabah* profit and shares the 'surplus' according to an agreed profit sharing ratio[36]. The *Takaful* operator as a result has two sources of income under this model: (i) profit share in net underwriting surpluses, and (ii) profit on their capital investments activities.

**Figure 6:** Modified *Mudarabah* Model Operational



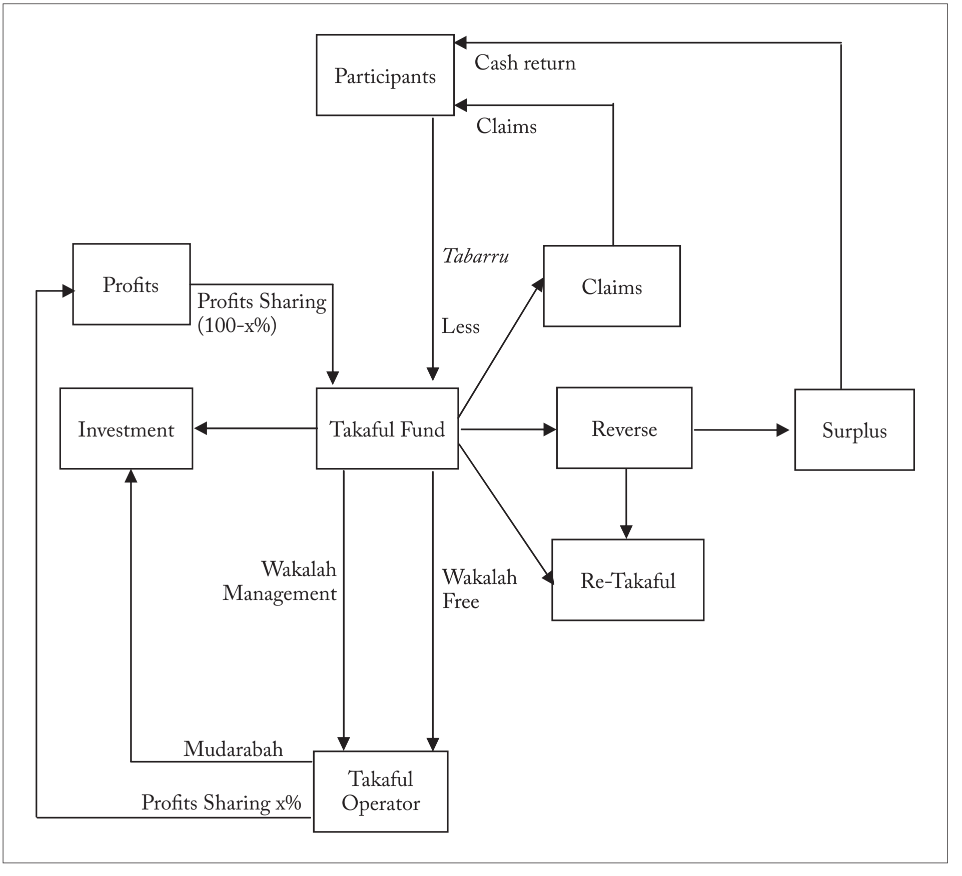

**Source:** Asaria (2009:10)

## Mixed Module

### *General Takaful (Wakalah for Underwriting & Mudarabah for Investments)*

Under this model[37] the *wakalah* contract is used for underwriting activities, risk assessments, re-*takaful* and in return for claim management, the *wakil* charges a specified and agreed management fee. This fee may vary based on the performance of the *takaful* operator (Engku *et al.*, 2008; Asaria, 2009). At the same time, a *mudarabah* contract is used for the purpose of investments in which the operator acts as a *mudarib* on behalf of the participants; that is the operator manages the *takaful* fund assets and share in the income generated from the investments based on a pre-agreed profit ratio at the contract inception period to satisfy the *Shar'iah* requirements. Unlike, the *wakalah* model, the operator receives a share in the profit once generated from investment, otherwise there would be no income generated for the operation; however, the participants remain liable for a loss encounter. The *Takaful* operator under this model has four main sources of income; (i) profit from the *wakalah* fee for underwriting activities, (ii) the profit share generated from asset management of the *takaful* fund, (iii) profit from the operator's own capital investments, and (iv) a possible sharing on the investment return, as an incentive fee for good performance.

**Figure 7:** General *Wakalah-Mudarabah* Model Operational

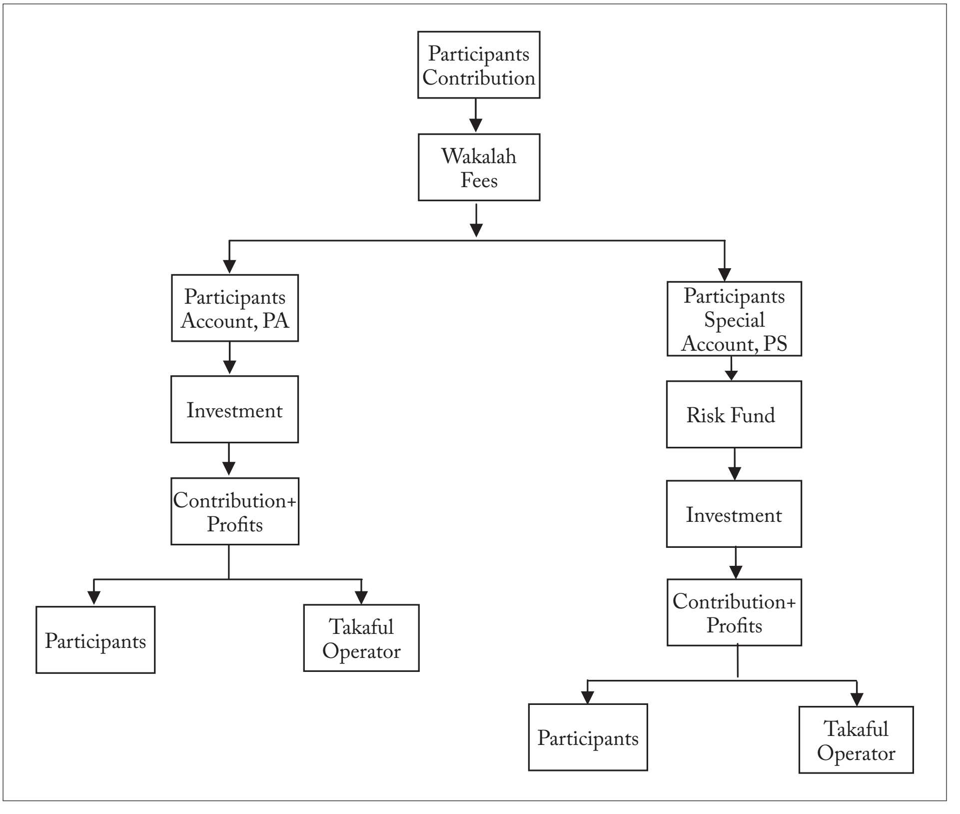



**Source:** Engku et al. (2008: 53)

### *Family Takaful (Wakalah for Underwriting & Mudarabah for Investments)*

Under this scheme the shareholders' fund and the PSA operate the same way as in the general mixed model, while the operator invests in the PA fund on a *mudarabah* basis, the generated profit will be shared between the operator and the participants upon the agreed ratio. The operator has five main sources of income in this model: (i) profit from *the wakalah* fee for underwriting activities, (ii) a profit share under PSA investment activities, (iii) a profit share under PA investment activities and (iv) profit from the investment of the operator's own capital coupled with (v) the possibility of incentive payments or 'good' performance fees.

**Figure 8:** Family *Wakalah-Mudarabah* Model Operational



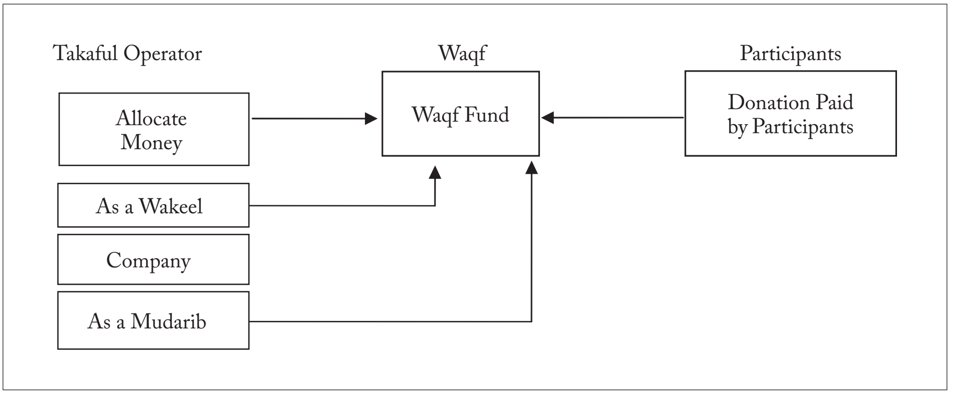

**Source:** IFSB (2009:30)

## *Waqf Takaful* Model

*A Waqf*[38] is established by the equity holders of the *takaful* company to compensate the beneficiaries or participants of the *takaful* scheme in the utmost sincerity in order to help those faced with difficulties (Ismail, 2006). The participants of the *Takaful* will give a premium under the intention of a donation or *'Tabarru'* to the *waqf* to participate in the objectives of the *takaful* principles; the donation of the *waqf* can be determined by the *takaful* company on the basis of an actuarial estimate. Any person signing the proposal form, contributing to the *waqf* and subscribing to the policy documents shall become a member and a beneficiary of that *waqf* fund (Ismail, 2006). However, shareholders do not have the right to access the *waqf* fund's capital, assets or profits but rather their job is to make rules for and administer the fund (Tolefat, 2008).

Claims on surplus after deduction and other expenses will be distributed according to the *waqf* deeds into three options: (a) a portion will be used as a reserve to mitigate any future losses, (b) a portion is to be distributed back to the participants, and a portion is to be distributed to the poor and for charitable purposes (Engku *et al.*, 2008). In case of a deficit in the fund the operator will provide *qard hassan* to cover the deficit. The *qard hassan* will be repaid from future surplus in the fund (Tolefat, 2008). *Waqf* is considered a legal entity that can exercise ownership rights over the contribution amount subject to the terms of the *waqf* deed, particularly on investments, compensations and the status of surplus amount (Engku *et al.*, 2008). Finally, if the fund is liquidated, then the outstanding balance, after the payment of all dues and payables, will be utilized for charitable purposes (Ismail, 2006).

**Figure 9:** The relationship between participants and the *takaful* operator in the *Waqf* scheme.




**Source:** Cizakca (1998)

***Takaful-Waqf operation models***

The *takaful* operator is the manager of the *takaful waqf* fund; hence they will administer the fund based on two forms;

(i) *Wakala - waqf*

As Operator/Manager, the *takaful* company will perform all functions necessary to manage the insurance activities of the *waqf*, such as the underwriting of contributions , the actuarial assessment of risks and payment of claims. The management will be conducted under a *wakala* fee to be deducted from the contributions of the participants.

(ii) *Mudarabah - waqf*
As *mudarib* of the fund, the *takaful* company will manage the investment of the excess funds of the *waqf* into *Shari'ah*-compliant investments and will participate in the profit of the fund's investments at a fixed, pre-agreed profit ratio.

## Other *Takaful* Models

### *The Sudanese model*

The system of *takaful* operating in Sudan worked the same way as the mixed *wakalah - mudarabah* model that *wakalah* used for underwriting activities and *mudarabah* used for investment activities. The operator acts as a manager looking after participants' funds and dealing with technical issues for a *wakalah* fee, however the fee is not calculated as a percentage of the total available fund rather as a lump sum to be used as remuneration to the board of shareholders. The remuneration amount is considered negligible compared with the regular *wakalah* percentage fee. A *wakalah* percentage fee of the total contributed amount was prohibited by the Higher *Sharia'h* Supervisory Council (HSSC) in Sudan; they considered the *wakalah* percentage fee as *riba* in the sense that the money is accumulated without any effort on the part of the company (Al-Darir, 2004). Al-Dariar argues that the participants of an Islamic insurance company should establish the company and should act as shareholders of the company in the same way as in the mutual insurance company. He also believes there is no need for capital in the Islamic insurance company except to satisfy the legal requirements to establish the company. The shareholders are not allowed to share the surplus of the *takaful* fund or to share in the investments' profits, and are also not required to provide *qard-hassan* in the case of deficit. The loan amount can be taken from the available fund reserves; if the reserves are not sufficient to compensate the deficit, then the operator will establish a central fund to act as the lender (Al-Darir, 2004).

### *The Saudi Arabian cooperative insurance model*

The Saudi Arabian Monetary Agency (SAMA) requires all insurance companies to operate under a cooperative insurance business model, which is a key feature of the *takaful* model (E & Y, 2010). *Shari'ah* scholars have indicated that the Saudi cooperative model is similar to a *takaful* model (in that it incorporates funds segregation and surplus distribution).

The cooperative insurance model works in the same way as the *takaful* model. The SAMA directives , officially set out in the Implemented Regulations, Article 70, has identified the surplus distribution as being between the company and the participants. SAMA has indicated that 10% of the net surplus shall be distributed to the policyholders either directly or in the form of reduction in premiums for the next year. The remaining 90% of the net surplus shall be transferred to the shareholders' income statement. Shareholders' net income shall be transferred to the statement of shareholders' equity similar to how this is conducted in the *takaful* model. Furthermore, 20% of the net shareholders' income shall be set aside as a statutory reserve until this reserve amounts to 100% of the paid capital (SAMA, 2005). Therefore, any deficit in the policyholders' fund is borne solely by the shareholders. Despite SAMA regulations, which are directed towards cooperative insurance, only a number of cooperatives operate as sole TO (E & Y, 2010, 2011). Examples of these operators are (AlJazira, 2008; SAAB, 2009; AlAhli, 2010).

## Conclusion

The main issue that distinguishes *takaful* from conventional insurance is the concept of *taburru* and the unique and fair treatment of participants which is quite obvious by separating the shareholders' fund from the participant's fund, in that each party will have his own balance sheet. Furthermore, some operators might use a homogeneous model such as *wakalah* or *mudarabah*, while the other might use a hybrid of *wakalah* and *mudaraba; namely,* they use the *wakalah* model for underwriting and the *mudarabah* one for investment. Such a mixed approach has been adopted by several operators worldwide[39]. Accordingly, *takaful* contractual concepts, terms and mechanisms will differ from conventional insurance in that in the *takaful* business there will be a strong relationship between participants and operators, participants and participants, participants and fund, operator and fund. Finally, *takaful* is still at the development stage with a number of challenges yet to overcome, such as innovative products, building *re-takaful* capacity, asset management and marketing channels, and the standardisation of *takaful* models worldwide.

# Endnotes

1 The word operator used in the takaful business instead of insurer, which shows a strong relationship between takaful company and its participants, that the operator considered as a custodian of the participants fund and not the owner of the fund, which comes in contrast of the conventional insurance that the conventional insurer is considered the owner of the fund.
2 Policyholders.
3 The Islamic law.
4 "Accounting Auditing Organization for Islamic Financial Institutions"
5 The concept of donation is considered to be the backbone of takaful in supporting the real meaning of mutual cooperation, as per [Quran, 5:].
6 The insurance value will be so intangible that its value cannot be appreciated
7 Al-Qaradawi suggests that donation should be the basis of the contract, if insurance is to be shari'a -compliant (Al-Qaradawi,2003). The spirit embodied in the concept of tabarru is that the participants are not thinking only of their own protection but they should also be thinking of helping other participants, without the concept of donation the contract will be that of buying and selling of insurance. (Lewis, 2003)
8 implementing the Islamic law when dealing with insurance
9 Continued charity such as building mosques, libraries, hospitals and schools on behalf of the participant upon his/her death
10 Based on three prohibition elements: (1) uncertainty of outcome (gharar), (2) gambling (maisir), and (3) dealing with Interest (riba) which is frowned upon by Shari'ah law.
11 Those among the participants who face the risk and are assisted by the fund are known as insured (almoaman alih).
12 The operator is defined according to Section 2 of the takaful Act 1984 as "a person who carries on Takaful business as Takaful operator, Takaful agent and Takaful broker respectively".
13 Those who contributed to the mutual fund (ra's al-mal) are known as participants (sahib al-mal), while those who actually benefit from the fund are known as the beneficiaries (al-mostafid) of the cooperative fund.
14 When the risk events occur.
15 The difference between pure tabarru and commitment to tabarru depends on the timing of the transfer of the ownership. In pure tabarru the ownership of the "mutabarri" (donator) is not transferred by the absolute contract wording, but rather transfer occurs while handling the donation to the needy, i.e. ownership of such materials "money" has been transferred from the donator to the needy once it reaches the needy custody. In the commitment to tabarru, the ownership is automatically transferred to the mutabarra (donated person) by the absolute contract
16 Based on an Interview with Dr. Abdul Sattar Abu Ghuddah, Member of the Islamic Fiqh Academy, Jeddah, at the First Public Meeting with Bank AlJazira Sharia Board Members, Hilton Hotel Jeddah, Oct. 2009.
17 if the contract is based on wakalah
18 if the contract is based on mudharabah
19 Such as perils or hazard.
20 If the participants are intending to invest some of the money as their savings and donate some portions for mutual indemnity, then the governing contract is musharakah, together with tabarru or donation of a portion of the contribution to the takaful fund (Ali and Odierno, 2008).

21 Such as “piety purification, brotherhood, charity (tabarru or contribution), mutual guarantee, community well-being as opposed to profit maximization.
22 Islamic General Insurance.
23 Islamic Life Insurance.
24 Within the scope of Family takaful are offered different types of saving and protection products, such as education, mortgage, retirement plans, protection for critical illness or disability, retirement annuities and waqf plans. A family plan may last as long as 10, 15, 20 years or more (Bhatty, 2008).
25 General takaful is more concerned with causality types of product in the form of individual retail products such as household fire protection, motor, medical and health cover, personal accident protection during Hajj season, or corporate segment products such as marine and aviation to cover transit cargo, engineering, or fire, the contract for which normally stands for one year.
26 The operator cannot ask for an additional wakalah fee in the future if the calculated fee was underestimated.
27 CCB Rulebook, 2005.
28 Such as claims, expenses, legal claims costs and re-takaful arrangements.
29 Such as salaries and rents.
30 Based on an agreed percentage of the total managed assets regardless of the investment performance.
31 It is wise to mention that some companies distribute the surplus for all participants including those who incurred a claim to satisfy the main purpose of insurance in Islam.
32 AAOIFI shari'ah standard No. 26 (5/5) of 2007 rules stated “Surplus can only be distributed back to the participants and cannot be taken by the takaful operator; the distribution of surplus will be based on the participant's donation percentage share”.
33 Participant's donation varies in accordance to his age at the time of the contract (Hassan and Lewis, 2007).
34 The participants do not pay their contribution for the mudarabah investment capital as a principal objective. The main objective remains to enter into a brotherhood mutual indemnity scheme by implementing the donation or tabarru contract.
35 The underlying argument is that since the operator will provide qard hassan to cover any deficit in the takaful funds, then the operator is entitled to share in the positive performance of takaful funds. Additionally they argue that the surplus is a result of ‘good' and expert management by the takaful operator especially in the underwriting of contributions, assessment of risks and claim management. On account of the fact that good management has contributed to the availability of the surplus , they should be consequently rewarded for such good performance.
36 Such a practice been criticized as not complying with the definition of profit in mudarabah and thus is not compliant with mudarabah rules generally (Engku et al., 2008; Asaria, 2009).
37 This model is highly recommended by the AAOIFI to be used by the takaful operator (AAOIFI, 2003). It has a dominating presence on both Middle Eastern and global markets.
38 The word waqf and its plural form awqaf are derived from the Arabic root verb waqafa, which means causing a thing to stop and stand still. The second meaning is simply pious (charitable) foundations (Cizakca, 1998). In Shari'ah, waqf is a voluntary, permanent, irrevocable dedication of a portion of one's wealth in cash or any other kind to Allah (Ismail, 2006).
39 Takaful international in Bahrain, National Takaful in Malaysia, Islamic Insurance company in Qatar.

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