An Overview on Takaful

Islam & Insurance –Historical Background

The concept of Takaful or Insurance is being used, as a risk mitigating tool, to cover the losses or hazards of uncertainty of its policy holders. It is based on the concept of mutual help and group responsibility.

It had been practiced since before the advent of Islam. Prophet Muhammad (Sal-lalAllah-u-alai-hi-Wasallum) approved them, though some of them are pre-Islamic:

- Doctrine of Al-Aqilah; Assistance provided to the killer by his or her family for paying of blood money to the heir of the victim.
- Doctrine of Dhaman Khatr at-Tareeq; A surety provided to the traders against the losses occurred during a commercial journey due to hazards on trade routes.
- Doctrine of Aqd al-Muawalat; A contract for bringing about the amity or revenge to an end.
- Doctrine of Al-Hilf; Confederation or agreement between different tribes or groups for mutual assistance and help.

Though by virtue of in built features of mutual cooperation and sharing, conceptually conventional insurance in its sprit is very much in line with Islamic fundamentals, and its operational frame work has been declared by Shariah Scholars in a Judicial Conference held in Makkah in Shaban, 1398 AH as un-Islamic (i.e. inconsistent with the principles of Shariah). In last few decades, similar Shariah Fatwas and Resolutions of historical significance have been passed at various forums.

Fiqh Academy Resolution 1985

Islamic Fiqh (science of Shariah) Academy, emanating from the Organization of Islamic Conference, meeting in its Second Session in Jeddah, KSA, from 10 to 16 Rabi-ul- Thani, 1405 A.H. (Dec 1985) issued a Resolution which in summary stated the following:

- **The commercial Insurance contract… is prohibited (Haraam) according to the Shariah.**
- **The alternative Takaful contract which conforms to the principles of Islamic dealings is Halaal, being the contract of cooperative insurance, which is founded on the basis of charitable donation and Shariah compliant dealings.**

Introduction-Takaful

“Takaful” – is an Arabic noun having origin in the verb “Kafala” meaning “to guarantee or to bear responsibility for …”. In simple, “Takaful” means an agreement wherein participants (members) of a group jointly guarantee each other to meet a defined loss/damage suffered by any one amongst them.

To sum-up, **Takaful** for religious Muslim offers **faithfulness** (in the form of making contribution for self purification), **brotherhood** (via ta’awun i.e. mutual assistance), **charity** (i.e. tabbarru meaning donation for a greater cause) and **mutual guarantee** (indemnification to the unfortunate ones amongst them for their loss/damage).

Reference — Al Quran:

- ***"Help (ta'awan) one another in furthering virtue (birr) and Allah consciousness (taqwa) and do not help one another in furthering evil and enmity". Al Maidah: verse 2 (5:2).***

Reference – Hadith:

- ***"tie the camel first, then submit (tawakkal) to the will of Allah"***

The hadith implied a strategy to mitigate/reduce risk.

A comparison between conventional insurance and takaful (keeping in view the underlying Shariah frame work) for ease reference, is drawn hereinafter:

Issue	Conventional Insurance	Takaful
Organization Principle	Profit for shareholders	Mutual for participants
Basis	Risk Transfer	Co-operative risk sharing
Value Proposition	Profits maximization	Affordability and spiritual satisfaction
Laws	Secular/Regulations	Sharia plus regulations
Ownership	Shareholders	Participants
Management status	Company Management	Operator
Form of Contract	Contract of Sale	Cooperative, Islamic contracts of Wakala or Mudarbah with Tabar'ru (contributions)
Investments	Interest based	Sharia compliant, Riba-free
Surplus	Shareholders' account	Participants' account

A Global Overview

Islamic finance is a fast growing phenomenon, which hardly holds 5% share of the global finance industry. In tandem with growth in Islamic finance, demand for Shariah compliant products for mitigating and managing the permissible risks, has risen significantly. From the inauguration of the first takaful company in Sudan in 1979, takaful products are now sold in around 30 countries through over 200 operatives (including takaful windows of conventional insurance providers).

Overall, global gross takaful contribution is estimated to reach US$14 billion in 2014 from an estimated US$12.3 billion in 2013. Year-on-year growth has moderated from a high CAGR of 22% (2007-11) to a still healthy growth rate of 14% over 2012-14. ASEAN countries (Malaysia, Indonesia, Brunei, Singapore and Thailand), driven by strong economic dynamics and young demographics, continue to achieve buoyant growth at 22% CAGR. The GCC countries (excluding Saudi Arabia) registered growth of about 12%.

However, despite phenomenal growth, takaful industry is merely 1% of the global insurance industry while Muslims represent around one-fifth of the world's population, suggesting potential growth opportunities for takaful to match the Islamic finance penetration, particularly in GCC countries, Malaysia and generally elsewhere.

Where as in Pakistan gross takaful (Family +General) contribution is Rs. 7.15 billion in 2013

Organization in Takaful

In conventional insurance, while risk transfer mechanism provides risk mitigation to individuals, the Company endeavors to maximize its profits in the process. However, the situation differs in Takaful wherein the operator acts as a wakeel under Wakala model {primarily aiming to optimize risk-mitigation cost for individuals (known a participants) in a Shariah compliant manner}, and risk-exposures remain within the group of such individuals who amongst them mutually guarantee each other.

The other important features in takaful are structure & purpose of the Participants' Takaful Fund (PTF), prohibition of investment in non-Shariah compliant avenues (fixed income securities and equity investment in prohibited businesses and financial services) and most significantly, a fair distribution of risks and rewards which necessitates clear divide between PTF and Shareholders' Fund (SHF).

Apart from the two funds i.e. PTF and SHF, the PTF of family takaful firms is further segregated to include a Participants Investment Fund (PIF), with the latter linked to units representing participants' rights to returns on investments. The existence of multiple funds in family and general takaful organizations require clear demarcation between assets of each, as it could raise governance concerns stemming from potential conflicts of interest.

In both family and general takaful, the shareholders, in theory, appoint a Takaful Operator (in practice, for the participants, they, as legal entity, are one), who independently manages the PTF. The contribution received from a participant in a General Takaful undertaking, is credited directly into the PTF, whereas in family takaful firms it is distributed between the PTF and the PIF. The position, due to risk-sharing element amongst the participants (i.e. policy holders) in Takaful, who mutually guarantee each other (as against transfer of risk from an individual to the company), put additional (socio-Islamic) responsibility on the participants, expected of them towards each other, under the brotherhood concept in Islam (the underlying basic spirit of Takaful); hence there is no contractual liability upon the takaful operator (TO) to cover any loss/deficit arising in the PTF. However, the SHF can provide Qard-e-Hasna (Interest free loan) to the PTF in times of financial distress (i. e. deficit in the PTF). The regulatory framework irrespective of jurisdiction gains significance here, since additional protection may have been provided to participants by ***obligating*** the SHF to cover for protection of participants' in adverse circumstances, even though in principle, it is not liable to meet any losses in the PTF.

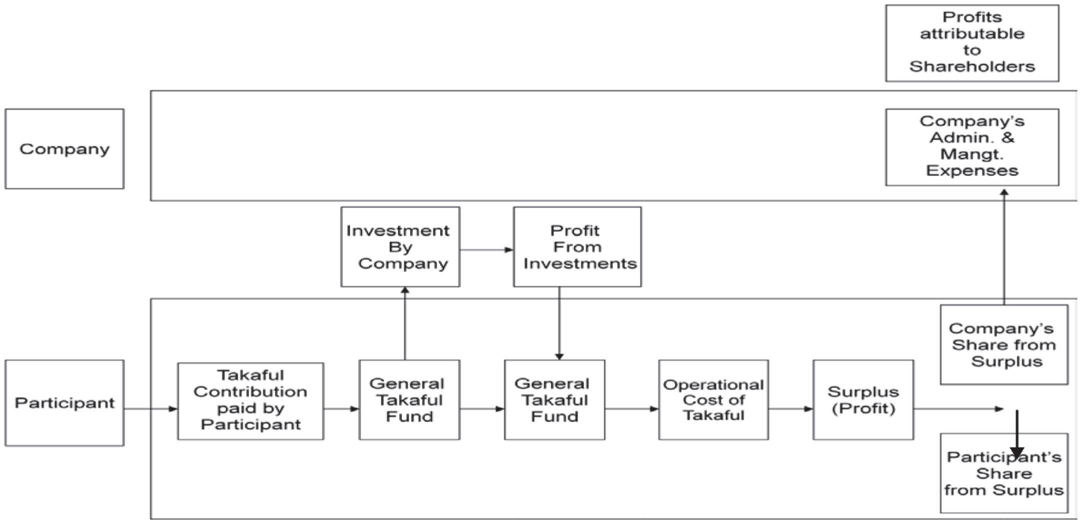
Takaful Models

As, guided by the fundamentals of Islamic business transactions, the contract of takaful, based on the principles of either Wakala or Mudharaba, has been developed, and is being practiced globally.

Following are the Takaful models used in world-wide by both Family and General Takaful Operators:

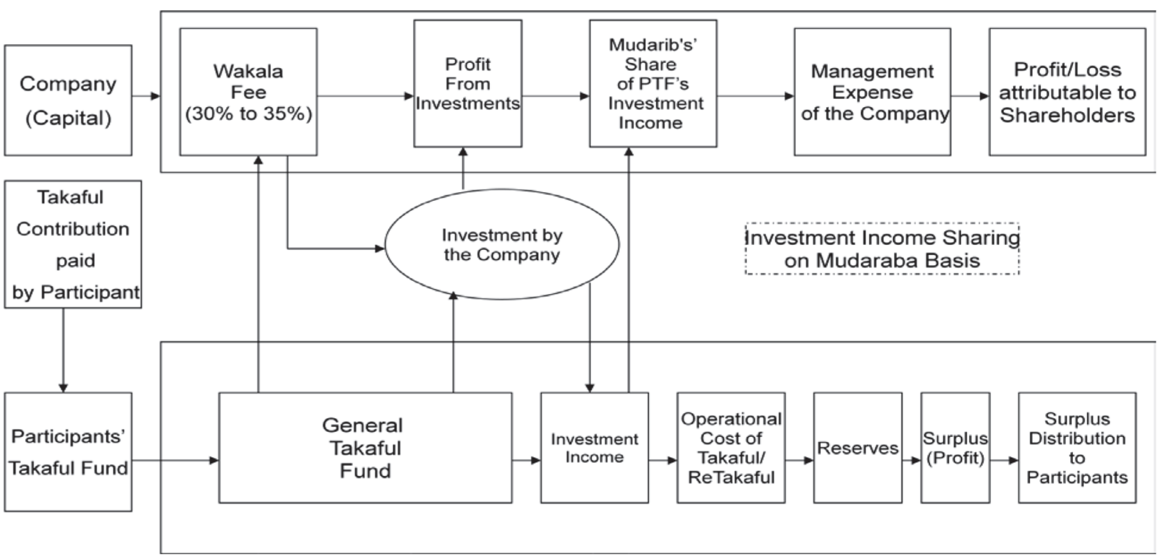
Mudaraba Model

The surplus is shared between the participants with a takaful operator. The sharing of such profit (surplus) may be in a ratio 5:5 , 6:4 etc. as mutually agreed between the contracting parties. Generally, these risk sharing arrangements allow the takaful operator to share in the underwriting results from operations as well as the favourable performance returns on invested premium.



Wakala Model

Cooperative risk sharing occurs among participants where a takaful operator earns a fee for services (as a Wakeel or Agent) and does not participate or share in any underwriting results as these belong to participants as surplus or deficit. Under the Al- Wakala model, the operator may also charge a fund management fee and performance incentive fee.



Wakala -Waqf Model

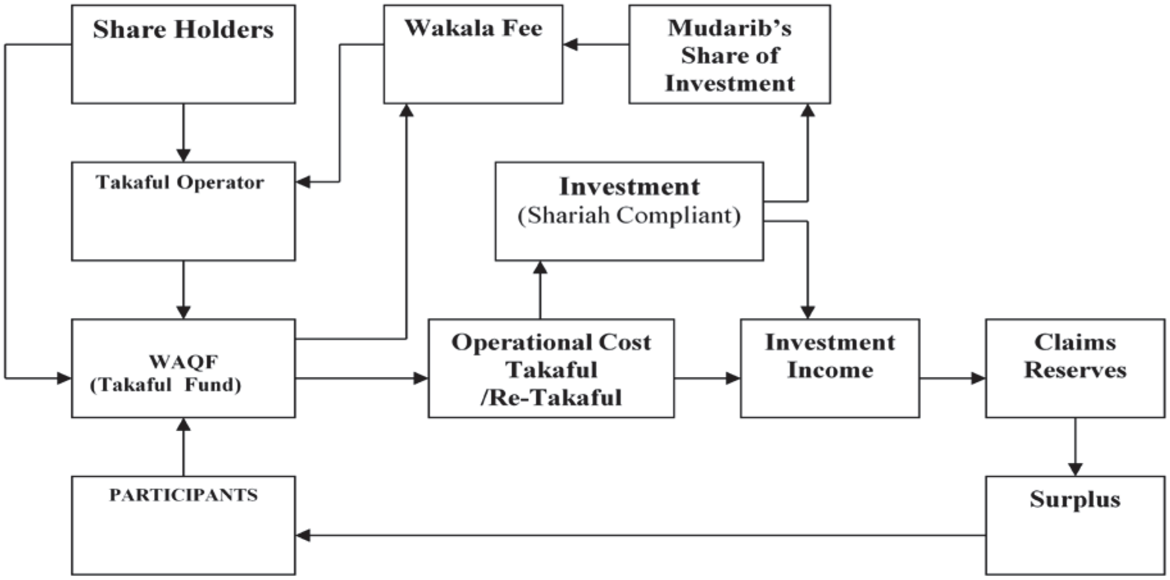
It is a WAKALAH model with a separate legal entity of WAQF in-between.

The relationship of the participants and the operator is directly with the WAQF fund. The operator is the 'Wakeel' of the fund and the participants pay contribution to the WAQF fund by way of Tabarru.

The contributions received would also be a part of this fund and the combined amount will be used for investment and the profits earned would again be deposited into the same fund which also eliminates the issue of Gharar.

Losses to the participant are paid by the company from the same fund.

Operational expenses that are incurred for providing Takaful services are also met from the same fund.



An over view of Pakistan's Takaful Industry (2006 – 2013)

Insurance Ordinance 2000 defines Takaful, as

> "A scheme based on mutual assistance in compliance with the provisions of Islamic Shariah and which provides for mutual financial aid and assistance to the participants in case of occurrence of certain contingencies, and whereby the participants mutually agree to contribute to the common fund for that purpose."

In Pakistan, to transact takaful business, both "Wakala" and Mudaraba" based contracts have been allowed under the Takaful Rules 2012 (repealing the Takaful Rules 2005),

The dedicated operators established under the repealed rules, by making an initial contribution (Cede money), form a benevolent fund (known as Waqf Fund). The participants (policy holders) contribute to the Waqf fund, and on request receive benefits for loss of or damage to the subject matter caused by fortuitous occurrence of defined events. As a matter of fact, in the Wakala-Waqf model, cooperative risk-sharing occurs among participants via pooling, whereas a takaful operator earns a fee for services rendered in managing of the fund (as manager of the fund/pool), and does not participate or share in any surplus or deficit of the pool (the Waqf fund).

Since notification of the Takaful Rules in September 2005, three general (namely "Pak Kuwait", "Takaful Pakistan", and "Pak Qatar General" commenced their operational activities in 2006, 2007, and 2008, respectively) and two family takaful companies (Pak Qatar Family and Dawood Family in 2008) have been issued licences by Securities and Exchange Commission of Pakistan (the Commission).

Sr. No	Name of Takaful Operator	Type of Business	Contribution-2013
1	Pak-Kuwait Takaful	General (Non-Life)	780 million
2	Pak-Qatar General Takaful	General (Non-Life)	1,029 million
3	Takaful Pakistan	General (Non-Life)	220 million
4	Pak-Qatar Family Takaful	Family (Life)	4,460 million
5	Dawood Family Takaful	Family (Life)	666 million

The gross takaful (Family +General) contribution is Rs. 7.155 billion in 2013.

Despite the continued impressive growth of takaful sector overall, this trend has not been consistent even across all product lines. Generally, the expansion of non-life business has outpaced that of the family lines. In addition, the typical size of a takaful company remains smaller than that of a conventional insurer.

Going forward, it is believed that the main opportunities and challenges for the sector overall are depending upon the development of more robust family takaful (life insurance) platforms in the family takaful (life insurance) business and compulsory lines such as motor third-party liability and health within the general takaful (non-life) business. A growth area within the corporate product line is medium-sized business risk products in the energy and construction sectors, which continue to expand. In general, retention levels for corporate product lines have been improving gradually, providing a more stable base for growth, although the largest risks still are expected to be ceded to the international markets.

The market position of the dedicated Takaful Companies by its diversification in terms of client base, business lines and distribution network is not up to the mark as compared to Conventional Companies.

Moreover, the development of Takaful (Islamic insurance) industry, including the regulatory environment, needs to keep pace with the rest of the financial industry, especially banking sector.

After enforcement of Takaful Rules – 2012, by which conventional insurance companies are allowed to open their window takaful, it is envisaged that takful industry especially Family takaful will flourish in future.

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