



Iranian Insurance Research  
Center(IRC)

# **TAKAFUL: NATURE, MECHANISM AND MODELS**

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# LECTURE PLAN

1. Conventional insurance
2. Takaful
  - Definition and background
  - Market share
  - Nature, mechanism and essential features
  - Is takaful Islamic?
  - Takaful models





# CONVENTIONAL INSURANCE



# WHY DOES INSURANCE MATTER?

Necessary risk-management support service for economic development and growth

Economic projects involve risks that are:

1. often too heavy to be taken by businesses personally
  - contractual – voluntary insurance
    - different types of insurance such as liability insurance, transport and travel insurance, home insurance, life insurance etc.
2. highly linked to public safety
  - mandatory insurance
    - Motor Insurance (Road Traffic Act of 1930)
    - Employers' Liability (Compulsory Insurance Act 1969)
3. to be covered by business practice as a requirement
  - documentary credit - banks reject opening one to finance an import without insurance cover
  - home mortgage

Absence of insurance can hinder economic and business risk-taking by businesses and other economic actors



# DEFINITION OF CONVENTIONAL INSURANCE

- A contract in which one party (insured) pays certain amount of money (premium) in exchange for a promise made by the other party (insurer) that they will pay to the former (or a named person) certain amount in case of a given future contingency.



# NATURE OF CONVENTIONAL INSURANCE

- Bilateral agreement involving premium payment by **insured** and obligation by **insurer** to provide financial protection
- (If) agreement; i.e. as and when certain insured contingency risk happen and the incident causes loss to the **insured** within an agreed term, then, the **insurer** is responsible to compensate
- Unknown Future contingency undertaking relying on the Law of Average and computer analysis
- Risk transfer arrangement



# SPECULATIVE RISKS UNINSURABLE

- Risks that involve both the chance of gain and loss
  - e. g. gambling at the racetrack
  - e. g. investing in the real estate market
- Speculative risks are uninsurable



# PURE RISKS INSURABLE

- Risks that involve only the chance of loss
- There is never an opportunity for gain or profit
- e.g. every time a man drives his car on the road, he runs a risk. there is the uncertainty of loss occurring to his car, to himself, to other road-users
- Pure risks are insurable only.





# WHAT IS WRONG WITH CONVENTIONAL INSURANCE?

- Majority view - impermissible
  1. Gharar
    - Relying on the law of average, parties undertaking future / if contingency obligations without sufficient knowledge of the nature, scope or outcome
    - can trigger enormous litigation and disputes
  2. Maisir
    - the insured is taking a gamble and the insurer is benefiting from this gamble
  3. Riba
    - insurance companies often invest their premiums in interest-bearing accounts
  4. Maal-ul-Haram
    - illegitimate income as one party becomes rich without making effort for it



# MINORITY VIEW OF CONVENTIONAL INSURANCE

- Permissible
  - Risks can be valued in the market which is certain
  - In aggregate, risks pose very little uncertainty, and are in line with public interest

**Professor Mustafa Al Zarqa, “The Insurance System: Its Reality and the Sahara Opinion”, Al Resala, (1962)**

**Muhammad Nejatullah Siddiqi, 1985, “Insurance in an Islamic Economy”, The Islamic Foundation, UK.**



# TAKAFUL





# DEFINITION AND BACKGROUND



# WHAT IS TAKAFUL?

- Derives from *Kafala* (to guarantee)
- In legal terminology means ‘social solidarity’
- Provision of mutual protection and guarantee
- An Islamic insurance enterprise that
  - was engineered to substitute CI
  - reduce exposure to risks while conforming to rules of *Shari’ah*
  - a cooperative model in which a community pools its resources to assist members
  - collective contract, not bilateral



# DEFINITION OF TAKAFUL

- “A collective agreement based on solidarity and brotherhood between two or more members who set up and contribute to, a collective fund to be used to pay off certain financial claims made against a member due to any unexpected loss within the agreed terms and period”

**[Muhamad Ayub, 2007]**

- “an arrangement based on mutual assistance under which takaful participants agree to contribute to a common fund providing for mutual financial benefits payable to the takaful participants or their beneficiaries on the occurrence of pre-agreed events”.

## **Section 2 (1) Malaysian Islamic Financial Services Bill 2012**

- “a process of agreement among a group of persons to handle the injuries resulting from specific risks to which all of them are vulnerable”

**AAOIFI, Shari’ah Standard No. 26 Islamic Insurance**



# TAKAFUL ROOTS

- *Takaful* has roots in *diah* (blood money) tradition' a pre-Islamic tradition and unwritten convention among Arab tribes in that "if a member of one tribe killed another from a second tribe, the tribe of the deceased (*aaqila*) could demand:
  - Either the offender be handed over and put to death (Qisaas),
  - Or a blood money (*diah*) paid to the heirs of the deceased person (*aaqila*)
- The entire tribe of the killer were responsible for payment of the blood money



# TAKAFUL DEVELOPMENT/INNOVATION

- Tribe and tribal link was replaced by voluntary association of individuals to a community
- Membership fee payment replaced the old tradition of tribal contribution payment for *diah*
- Liability to pay *diah* was replaced by the new liability to make voluntary gratuitous fee payment to be used as compensation at times of loss
- Premium contribution and getting compensation
- **Birth of *Takaful***







# MARKET SHARE



# TAKAFUL ASSETS BY REGION, 2021

Region	Assets (USD m)
Other MENA*	30,080
GCC	23,597
Southeast Asia	15,457
South Asia	2,106
Europe	1,637
South America and Caribbean	4
Other Asia	0.04
<b>Total</b>	<b>72,880</b>

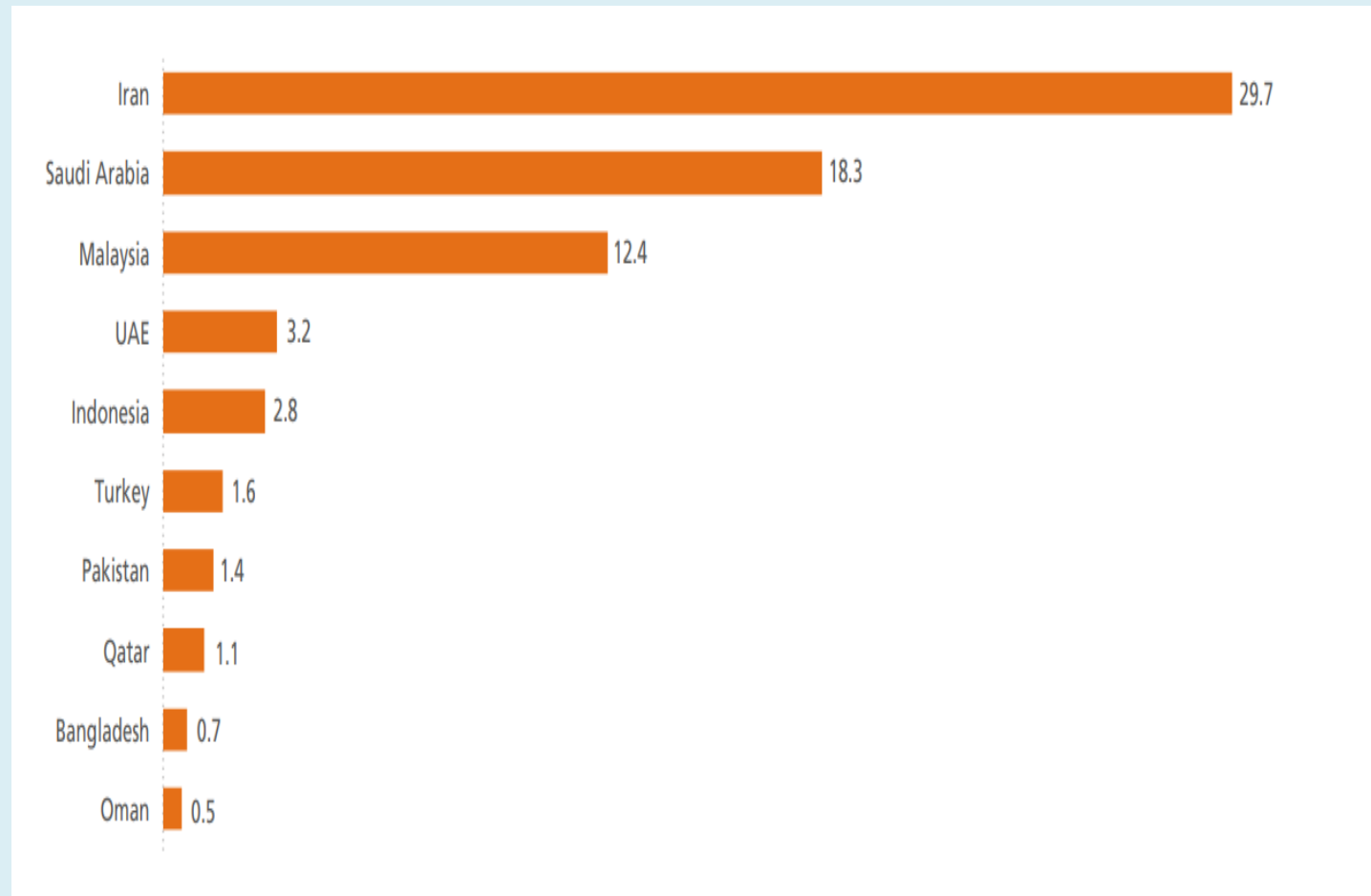
Source: TheCityUK and Refinitiv data

\* Other MENA: Algeria, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Mauritania, Morocco, Palestine, Sudan, Syria, Tunisia, and Yemen.

- Takaful market is the smallest segment of Islamic finance industry
  - In 2021, Islamic banking is the largest segment, boasting assets globally totalling \$2.8 trillion
  - Sukuk market is the second largest segment, with assets amounting to \$196.5 billion.
  - Takaful assets, totalling \$73 billion, make up the third-largest segment

# TOP COUNTRIES IN TAKAFUL ASSETS, USD BN, 2021

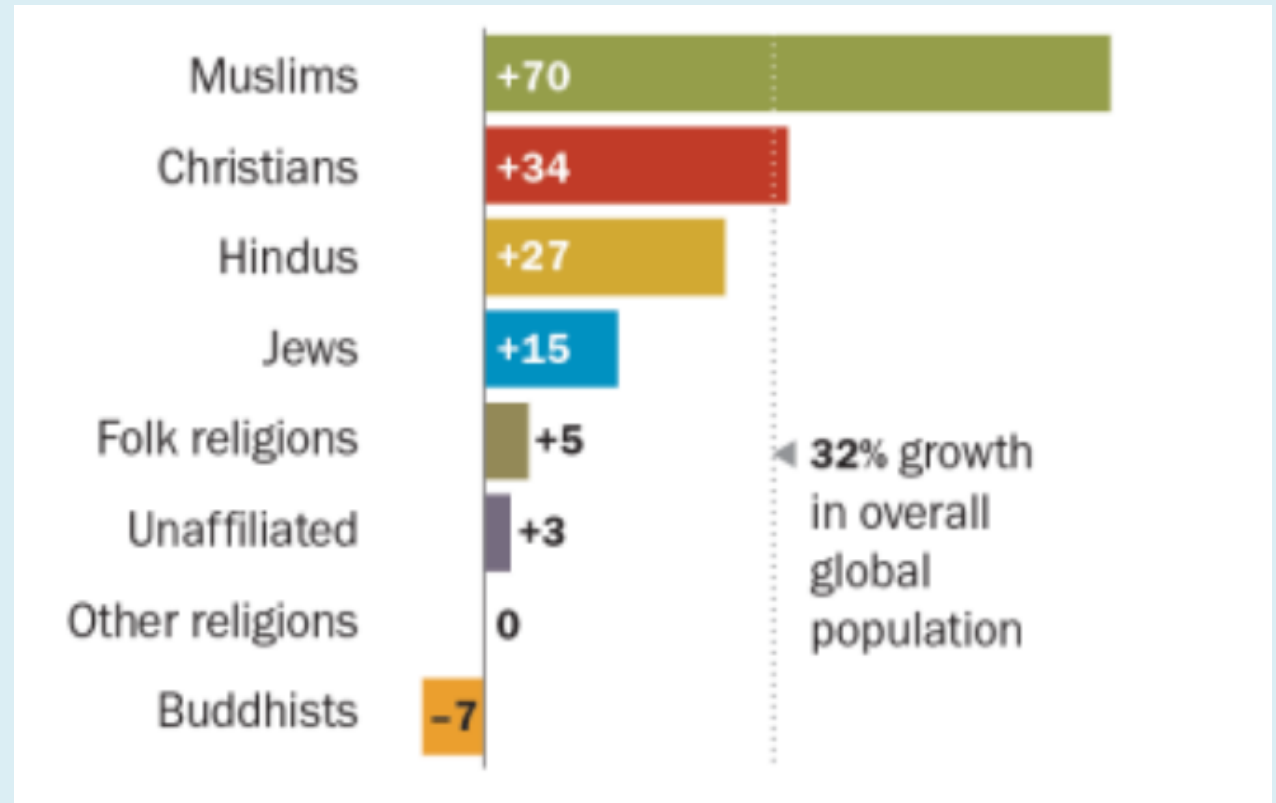
- 95% Global takaful assets concentrated in three regions: GCC, Southeast Asia and Other MENA (Algeria, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Mauritania, Morocco, Palestine, Sudan, Syria, Tunisia, and Yemen).



Source: TheCityUK, "Islamic Finance: Global Trends and the UK Market" 2022

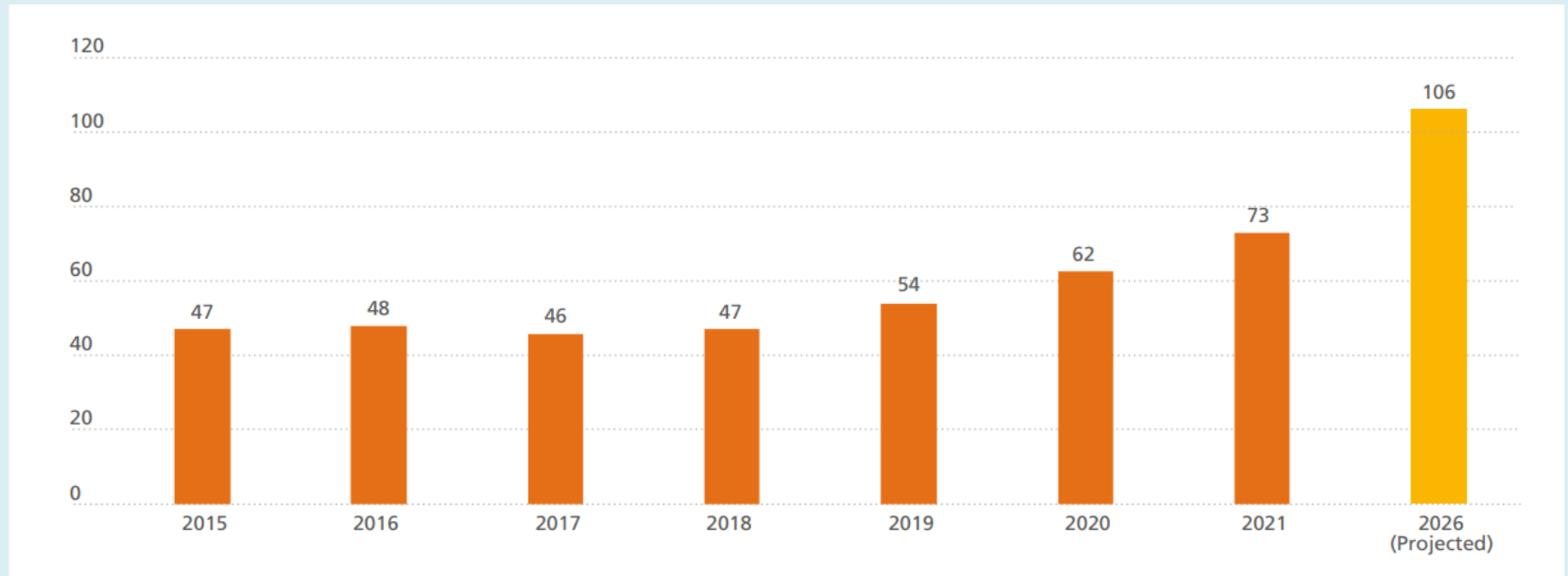
# ESTIMATED PERCENT CHANGE IN POPULATION SIZE, 2015-2060

▪ Today, the world Muslim population who are the principal direct stakeholders of takaful products is 1,703,146,000 which is %21.2 percent of the total world population (8,045,311,447) and it is projected to grow fast



Source: Pew Research Center Demographic projections

# EVOLUTION OF TAKAFUL MARKET ASSETS, USD BN, 2015-21



Source: TheCityUK and Refinitiv data

- Global takaful assets have experienced steady annual growth of 8% from \$47 billion in 2015 to \$73 billion in 2021, with a notable increase of 17% in 2021 alone. Projections indicate that the market is expected to further expand to \$106 billion in assets by 2026, reflecting its upward trajectory.



# **NATURE, MECHANISM AND ESSENTIAL FEATURES**



# NATURE OF TAKAFUL

1. Takaful is a hybrid arrangement / organisation
  - a NGO (Not-For-Profit, Guild, Co-operatives)
  - a business
2. Takaful's objective is twofold
  - Philanthropy
  - Profit seeking
3. Division of fund into
  - Compensation fund
  - Investment fund
4. Takaful operator acts as an agent, however unlike a simple agent, it has the right to control the fund
5. The NGO (the contributors) vest their right to control to the Operator, except the right to exit
6. Takaful is therefore both a business and a NGO, "two in one"



# MECHANISM OF TAKAFUL

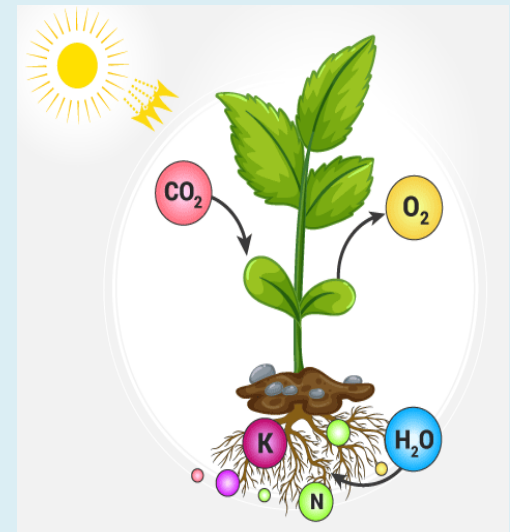
1. Takaful organisation is set up as a hybrid of business / NGO (Not-For-Profit, Guild, Co-operatives) controlled by private founders/owners
  - Make the initial funding necessary to set up Takaful
  - Often known as Operator
  - Just like an agent, responsible to receive and manage takaful fee contributions and takaful fund on behalf of members
2. The Society of common contributors to and users of philanthropic takaful fund
3. Hybrid arrangements - nexus of contractual relationships between Operator and joining members (the Society)
  - To regulate business/investment fund via *Wekalah, Modarabah* contract
    - members allow takaful organisation to take control of the takaful fund
    - contract regulate relationship between takaful organisation and members
  - To regulate the philanthropic aspect of the relationship via *Hiba* (gift), *Waqf* (endowment) contracts between every member and the member who suffered a covered loss





# ESSENTIAL FEATURES OF TAKAFUL AS A NGO

1. Cooperation (*taavon*)
  - “... sustain a mutual cooperation among yourselves in righteousness and piety” [Quran, 5:2]
2. Social welfare and solidarity just like *zakah* (mandatory charity) and *sadaqah* (voluntary charity) and *hibah* (donation).
3. Collective ownership and control; i. e. insureds are the insurers (though the latter is often vested in management, a takaful organisation separate from the body of members)
4. Philanthropy, not a mutual bargain



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**IS TAKAFUL ISLAMIC?**



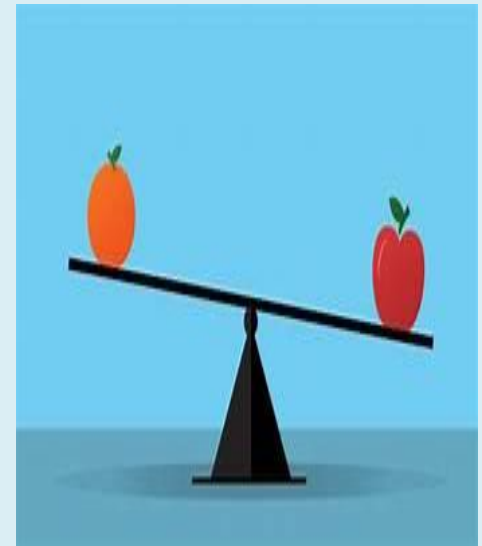
# WHAT MAKES TAKAFUL ISLAMIC?

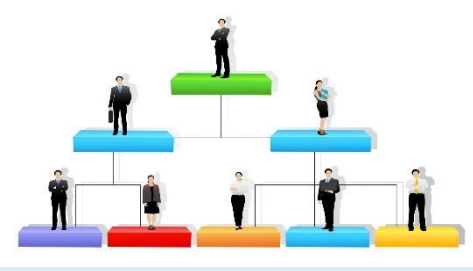
1. Risk share rather than risk transfer (compatible with PLS)
2. Co-operation rather than selfish competitive behaviour (*Ta'awun*)
3. No bargain and non exchange charitable status, a non-for-profit-organisation that tolerates gharar, if any (*Tabaru*).
4. No *Gharar* because the relationships have been broken into a nexus of separate contracts each qualify for certainty; i. e. (1) philanthropic contribution (*Tabaru*) and (2) philanthropic distribution (*infaq*) which occurs post risk incidence which is certain.
5. No *Maisir* (gambling)
6. No *Riba*
7. No *Mal-ul-haram* involvement



# COMPARISON OF TAKAFUL AND CONVENTIONAL INSURANCE

1. Collective v Bilateral agreement
2. Collective ownership of insurance fund by takaful members v third party (insurer company) ownership
3. Takaful member profits v profits to third party (shareholders of the insurance company)
4. Cooperation v Competition
5. Social risk v Individual risk elimination
6. Social welfare v Individual welfare maximization



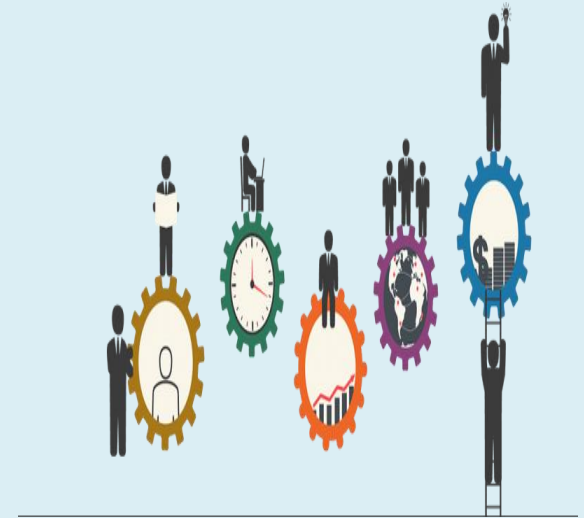


# TAKAFUL MODELS



# APPLIED MODELS

1. *Ta'awun/Tabaru* (philanthropic) models
  - *Waqf*
2. *Tajarah* (business) models
  - *Wakalah*
  - *Mudharabah*
3. Mixed models
  - *Wakalah and Mudharabah*
  - *Wakalah and Waqf*
  - *Waqf and Mudharabah*



# WAQF MODEL

- A contract of philanthropy of 3 types:
  1. Public - the benefit of a charitable / humanitarian objective
  2. Private - the benefit of a specified group of people (e.g. members of donor's family)
  3. Religious - preserving religious objectives
- Beneficiaries in a *Waqf takaful* are contributors to *Waqf* fund
- Members contribute for the purpose of mutual help
- Compensation paid from *Waqf* Fund
- Takaful organization is authorized to act as agent (*Mutavalli*) of the *Waqf* and contributors / beneficiaries in return for a fee
- There is no separation of fund into compensation and business funds
- Not-for-profit business operation - takaful organisation cannot use fund to invest or engage in business and make profits
- This model was adopted by Bank Aljazeera and applied in Takaful operations across Saudi Arabia
- As it is pure philanthropy, it is not common among Islamic insurance businesses



# WAKALAH (AGENCY) MODEL

- Contributors (Principal) appoint *Takaful* Operator as AGENT to manage Takaful Fund for a twofold purpose of compensation and investment
- Contributions held into two separate accounts
  - protection (compensation) fund to pay potential claims
  - investment fund for putting into permissible business and maximise profit
- Takaful Operator is given an agreed Fee for services but will not take any share in potential profit or loss
  - agency (*Wakalah*) plus reward (*Jualah*) as incentive is possible
  - contributors share all profits and loss. Loss, if any, borne only by contributors
- Generally practised in middle east region
- Criticized for being inefficient and unfair to contributors, Why?
  - Operator does not take any risk of loss
  - cooperation and tabarru (donation) inconsistent with profit seeking activity in the agency model
  - investment fund is returned along with profit, if any, to policyholders which is not consistent with general Insurance policies and practices





# MUDARABAH MODEL

- Contributors (*rab-ul-mal*) appoint Takaful Operator as *Mudarib* (a specific form of agent) to manage Takaful Fund for twofold purpose of compensation and investment
- Contributions held into two separate accounts
  - protection (compensation) fund to pay potential claims
  - investment fund for putting into permissible business and maximise profit
- *Takaful* Operator share with participants in potential returns from investments of fund (e.g. 50:50, 60:40) but there will be No service fee. If there is no profit, Operator will receive no profit
- Loss of investment borne by policyholders not *mudarib* (*takaful* Operator)
- Practised mainly in the Asia–Pacific region, Malaysia with the induction of Syarikat Takaful insurance company, also practiced in Brunei.
- Criticized for being inefficient and unfair to contributors
  - Operator does not take any risk of loss
  - cooperation and *tabarru* inconsistent with profit seeking activity of the *mudarabah* model
  - investment fund is returned along with profit, if any, to policyholders which is not consistent with general insurance policies and practices



# MIXED MODEL

1. *Wakalah and Mudharabah takaful*
  - *Takaful* operator will receive both fee (under *Wakalah*) and a share of profits, if any (under *Mudharabah*)
  - Profits will be shared between participants and the Operator based on *Mudharabah*
2. *Wakalah and Waqf*
  - *Takaful* Operator receive compensation fee under *Wakalah*
3. *Waqf and Mudarabah*
  - takaful Operator receive some portion of profits under *Mudarabah*





# QUESTIONS



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**Thank you**



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