

CIFE16: UNDERSTANDING TAKAFUL – ISLAMIC INSURANCE

You learn the difference between Islamic and conventional insurance and the essentials that make Islamic insurance unique.

Islamic Insurance is based on mutual assistance and co-operation through voluntary contributions to a common fund that provides its members mutual indemnity in the event of loss.



Prohibition of Conventional Insurance

Conventional insurance is prohibited as it possesses the following elements:

- **Gharar:** Contractual uncertainty that leads to dispute.

Gharar exists in conventional insurance as one party in the contract, the insurer, has a right to profit from the investment of insurance premiums and the other party, the insured, does not have access to its funds.

- **Maisir:** The element of speculation in a contract.

In conventional insurance, the insured pays a premium expecting a much greater amount in case of loss, but loses the entire premium when an uncertain event does not occur.

- **Riba:** Any amount that is charged in excess which is not in exchange for a due consideration.

Conventional insurance possesses the element of riba in two ways:

- It involves direct riba in terms of the excess that is involved in an exchange between the insured's premium and the insurer's payment against a claim.
- It involves indirect riba based on the interest earned on interest based investments made by the insurance company with the insured's premium.

Differences between conventional insurance and Islamic cooperative insurance

Conventional Insurance	Islamic Insurance
The conventional insurance contract is a purely financial contract involving uncertainty.	The Islamic insurance contract is based on co-operation and seeks mutual benefit through contributions to a common fund.
The insurance company executes the contract in its own name.	The insurer serves as the insured's agent to manage operations and invest premiums based on Mudarabah. The insured has equity in the pooled funds.
The insurer owns the premiums in return for being obliged to pay insurance claims	The cooperative insurance account is the owner of funds.
All the premiums after deduction of insurance expenses are considered the insurer's revenue.	Any surplus after deduction of expenses from the premiums is distributed among the members of the insurance fund based on their contribution ratios or any other method agreed upon in the insurance policy.
All returns from investment transfer to the insurer.	The Mudarabah based return from investment of premiums, after deduction of the Mudarib's share, belong to the fund members.
The insured and the insurer are two separate entities; the seeker of insurance and its provider.	The insurer and the insured are the same; members of a mutual fund seeking to indemnify each other against loss. The participants pool together their risk and their premiums to share them.
Provides protection against speculative risk in addition to pure risk.	Only provides protection against pure loss exposures.
The amount left over in the insurance account at the time of liquidation is kept by the insurance company.	The amount left over in the insurance account is disbursed to charity at the time of liquidation.

Speculative Risk

Speculative risk is the risk that involves the possibility of loss, no loss or gain. For instance, the risk involved in a new business venture.

It is prohibited to insure speculative risk as it entails gharar with respect to the probability of gain as well as that of loss.

Pure Risk

Pure risk involves the possibility of loss. For instance damage to property due to a fire. Such risk can be insured Islamically as it does not involve uncertainty with regard to the probability of gain as well as loss.

Islamic Insurance - Essentials

1. Islamic insurance offers risk protection based on Shariah principles of mutual co-operation.
2. It is offered on the principles of good faith where both contracting parties make full disclosure of all relevant material facts without intending to manipulate, cheat or disadvantage each other.
3. Based on three main relationships, the Musharakah between participants of the joint fund, the Wakalah between the Islamic insurance company and the insurance policy holders and a Mudarabah between the insurance policy holders and the fund itself.
4. The insurer in his capacity as the agent cannot guarantee premiums and can only be liable in case of his proven negligence.
5. The insurer and the insured must fulfill their responsibilities in the contract. This may include conditions that do not affect the co-operative nature of the agreement.
6. The insurance company may charge a fee for its services as agent of insurance operations. However, the returns from the investment of premiums in Shariah-compliant endeavours based on the Mudarabah must be distributed between the insurer and the insured according to their investment ratios.
7. In case of loss to members, the Islamic Insurance company may demand indemnity from the party responsible for damage. Additionally, it may take all necessary action to receive the insurance amount on behalf of its participants. Alternatively, the participants of the Islamic Insurance company and the party causing the damage may even reconcile with one another according to Shariah principles.
8. A Shariah advisory board must be established to supervise insurance operations and ensure Shariah-compliance

Types of Islamic Insurance

There are two types of Islamic insurance:

- Property insurance; or insurance against injuries or mishaps such as fires, earthquakes, car accidents and so on.
- Personal insurance; which refers to indemnity against the risk of disability or death, also known as Takaful.

Islamic Insurance - Duration

Islamic Insurance requires both the insurer and the insured to adhere to certain time limits.

- The insured must make timely payment of premiums, if he doesn't, the insurer is within his rights to withhold indemnity, cancel the contract or alternatively take legal action and pursue due payment from him.
- The insured must provide evidence for a claim within a stipulated period of time. On the other hand, the insurer must follow through with providing timely and agreed upon indemnity for loss to him.
- The insurance contract runs its course for a specified term before it expires. It is also terminated upon damage to insured property or death of the insured, as in such cases the object of commitment ceases to exist.

Islamic Insurance - Overview

Islamic Insurance funds are invested in a joint pool created to share risk and provide its members mutual guarantee and protection against it.

The fund is managed by one of its members in exchange for a payment of a fixed fee or alternatively a manager is hired for the job.

The operator manages the funds in the pool, maintains a part of the funds to pay for claims and invests the rest in Shariah-compliant business ventures.

In case a loss is experienced by any member of the pool it is distributed equally amongst all its participants and is made up for from the funds within the pool.

In the event of a profit from business investments, it is distributed among the investors according to their investment ratios.

After the fulfillment of claims, if any, the operator is remunerated for his services from the amount in the pool and the remaining balance is distributed among its members.

Re-insurance

A new insurance arrangement consistent with Islamic insurance principles and guidelines provided by the Shariah board. It is enacted in the event that the amount in the original fund is insufficient to meet the needs of its members.