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CRITICAL REVIEW ON THE PREVAILING TAKAFUL MODELS

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*Abstract: Takaful industry is one of the fastest growing financial institutions and its rapid growth is impressive. It has been widely accepted in both Muslim and non-Muslim countries. Still, its main competitor is the insurance industry and Takaful industry is relatively new compared to the insurance industry. Since most of the Takaful products are offered by the commercialized companies similar to the insurance industry, Muslim scholars have gradually created Takaful models which will be suitable for the Takaful operators in order to be viable in terms of profitability, risk management while abiding the Shari'ah requirement. The purpose of this paper is to make a comparison among the Takaful models from seven aspects, including splitting the participant contribution, payment for Re-Takaful contribution and reserves, operating expenses, surplus sharing, profit sharing from the PIF, claims, surrender, maturity and interest free loan. Seven Takaful models, namely, Cooperative (*Taa'wuni*) Model, Pure* Wakalah *(Agency) Model, Modified Wakalah Model (*Wakalah *with Incentive Compensation), Pure* Mudarabah *(Investment Profit-Sharing) Model, Modified* Mudarabah*Model, Hybrid* Wakalah-Mudarabah *Model and* Waqf *Model are compared. The findings show that there is a slight variation in the case of contribution, payment for operating expenses including the commission, surplus and profit sharing. However, the rests are the same in all models.*

Key words: *Insurance, Takaful Model*

1. INTRODUCTION

Takaful becomes well-known as an alternative to conventional insurance since a few decades. It is widely offered by the commercialised companies all over the world. The main competitors of the Takaful operators (TOs) are insurance companies which have been in the market much earlier than the former ones. Takaful operators need to be very competitive in offering the products in order to gain more market share and maintain the sustainable business while abiding the Shari'ah requirements. Insurance companies involve in the activities which are based on the interest, uncertainty and gambling and these prohibited factors make these companies non-*Shari'ah* compliant. Takaful operators have to avoid the prohibited elements by creating Takaful contracts which are based on a few Takaful models.

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Takaful models have been gradually developed to ascertain that it is beneficial to the Takaful operators and participants within the framework of *Shari'ah*. The most popular Takaful models available in the market are Cooperative (*Taa'wuni*) Model, Pure *Wakalah* (Agency) Model, Modified Wakalah Model (*Wakalah* with Incentive Compensation), Pure *Mudarabah* (Investment Profit-Sharing) Model, Modified *Mudarabah*Model, Hybrid *Wakalah-Mudarabah* Model and *Waqf* Model. These models are vital since these models determine the contractual relationship between Takaful operators and participants. However, to the extent of my knowledge, there is no comparative analysis on these models in terms of splitting the participant contribution, payment for Re-Takaful contribution and reserves, operating expenses, surplus sharing, profit sharing from the PIF, claims, surrender, maturity and Qard. Thus, this paper will focus on it.

This paper is written in five sections. Second section explains what is insurance and why it is prohibited in Islam. Third section discusses Takaful and its models. Fourth section provides the comparative study on seven Takaful models and the last section concludes this paper.

2. INSURANCE AND PROHIBITION IN ISLAM

2.1. Insurance

International Risk Management Institute (2014) defines insurance as "a contractual relationship that exists when one party (the insurer) for a consideration (the premium) agrees to reimburse another party (the insured) for loss to a specified subject (the risk) caused by designated contingencies (hazards or perils)." By referring to the definition of insurance, the main cause for the policy holders to buy insurance is risk. Risk is born since we come into this world and it is with us forever. In our personal life, we can accidently meet any misfortunes such as car accident, fire, flood and etc. In the business activities, risk remains important for the companies to manage. Some of the business risks are operational risk, reputational risk, regulatory risk and etc. One of the means to mitigate the unwanted risk is buying insurance (Global Risk Management Survey, 2013).

Many insurance products are available to cater the various aspects of our needs. The main groups of the insurance products are general insurance products and life insurance products. General insurance products include motor insurance, marine insurance, house insurance and etc. Life insurance products include pension plan, education plan and health insurance. Insurance industry is not only providing the claims to the policy holders but also the backbone of the financial system of any country. This sector is supporter for the growth of country's economy. Since this sector is important, it is highly regulated by the government. Its importance is undeniable for our daily life and the environment where we are surviving is pushing factor for us to have insurance. For instance, buying motor insurance is compulsory for the car drivers in most of the countries such as United States of America, Canada, United Kingdome and etc.

Unfortunately, Muslim scholars declare that practice of insurance is not in line with the teachings of Islam. The practice of insurance includes Riba (interest), Gharar (uncertainty) and Mysir (gambling) (Htay& Salman, 2013;2014).

2.2. Prohibition of Insurance Practices in Islam

2.2.1. Prohibition of Riba in Islam

According to El-Gamal (2000), Riba means ''unearned'' capital or wealth '' illogical increase'' or ''an unfair'' or ''unequal exchange'' between two parties. Interest has been clearly prohibited in the Qur'ân and Hadith:

> "O those who believe fear Allah and give up what still remains of the riba if you are believers. But if you do not, then listen to the declaration of war from Allah and His Messenger. And if you repent, yours is your principal. Neither you wrong, nor be wronged. And if there be one in misery, then deferment till ease. And that you leave it as alms is far better for you, if you really know. And be fearful of a day when you shall be returned to Allah, then everybody shall be paid, in full, what he has earned. And they shall not be wronged." (Surah Al-Baqarah, 275-281)
>
> Narrated 'Umar bin Al-Khattab: Allah's Apostle said,
>
> "The bartering of gold for silver is riba, (usury), except if it is from hand to hand and equal in amount, and wheat grain for wheat grain is usury except if it is from hand to hand and equal in amount, and dates for dates is usury except if it is from hand to hand and equal in amount, and barley for barley is usury except if it is from hand to hand and equal in amount" (SahihBukhari).

The main reason for the prohibition of *Riba* is because of the unfairness to the society. The wealthy people can lend the money on interest and when due, they will be receiving the interest in addition to the principal lent. Interest is still imposed on the borrower regardless of the profit or loss of borrower's business. As a result, it will make the rich richer and the wealth will be circulating among the rich only. It will increase the gap between the poor and the rich and create hatred and envy towards the rich. Moreover, the practice of interest does not have the value added on the production and just creates burden on the borrower.

Conventional insurance is purely based on the element of Riba, whether it is life or general insurance. The main objective of the insurance company is to generate interest income by investing its funds into traditional investment instruments. The policyholders have to pay surcharges if they fail to pay their premium on time. Moreover, when life insurance policy reaches its maturity/death claim, the amount payable under such policy is much more than the amount received by way of premium. Both in general and life insurance, the insurance funds are invested in instruments which are interest based (Qaiser, 2014).

2.2.2. *Prohibition of* Gharar *in Islam*

Ayub (2007) states that *Gharar*means hazard, chance, stake or risk.The general meaning of *Gharar*includes "that those consequences are hidden", "that whose nature and consequences are hidden", "that which admits two possibilities, with the less desirable one being more likely" or that whose consequences are unknown" (Frenz&Soualhi, 2010). The practice of *Gharar* is prohibited in Islam and it can be referred to the following sources of *Shari'ah*.

> O you who believe! Intoxicants (all kinds of alcoholic drinks), and gambling, and Al-Ansab, and Al-Azlam (arrows for seeking luck or decision) are an abomination of Shaitan's (Satan) handiwork. So avoid (strictly all) that (abomination) in order that you may be successful. Shaitan (Satan) wants only to excite enmity and hatred between you with intoxicants (alcoholic drinks) and gambling, and hinder you from the remembrance of Allah and from As-Salat (the prayer). So, will you not then abstain? (Surah Al- Al-Ma'idah, 90-91)

> Abu Huraira (Allah be pleased with him) reported that Allah's Messenger (may peace be upon him) forbade a transaction determined by throwing stones, and the type which involves some uncertainty. (Sahih Muslim)

Gharar is not inherent in any business activities and it is purposely created by one party to get advantage over the other party. Hence, it will cause unfairness in the business dealing.The consequence of uncertainty will be the dispute between the contracting parties and it will have a negative impact on the harmony among us. It will prevent realising social and economic justice. The practice of insurance involves uncertainty because it is not sure for what the policy holders are paying the premium. It is not sure whether the claims will be made by the policy holders or not and whether the misfortune hits the policy holders.

2.2.3. *Prohibition of Maysir (Gambling)*

Once insurance practice is not free from *Gharar*, *Maysir* is automatically involved (Muhaimin, 2005).*Maysir*refers to a situation where a person gets involved or unnecessary risk is taken by him, when he enters into a transaction where the chance of gain is less or fear of loss is more (Zuriah&Redzuan, 2009). Its prohibition can be referred to the following sources of *Shari'ah*:

Prohibition of *Maysir* (Gambling) in the Qur'ān:

> They ask you (Prophet) about intoxicants and gambling: say, "There is great sin in both, and some benefit for people: the sin is greater than the benefit." They ask you what they should give: say, "Give what you can spare." (Surah al- Baqarah, 219)
>
> The Noble Prophet said: "Whosoever says to his companion: 'Come let us play a game of chance', should give charity (as atonement)." (SahihBukhaari and Sahih Muslim)

Gambling will not be fair to all involved parties because one party can win if and only if the counter party loses. In insurance, it involves gambling because it is the game of gain or loss. If the policyholders make the claims, it will be the loss for the insurance companies and if there is no claim, the insurance companies profit and the policyholders will get nothing and lose their premium. Actuaries use the statistical method to estimate the probability of gain for the insurance companies and then, the underwriting process and premium is determined. Hence, it is trying to ensure that insurance companies are in the upper hand to benefit more from the game.

Since insurance practice is not free from prohibited elements from *Shari'ah*, Muslim scholars prohibit it. This is evidenced in the First International Conference on Islamic Economics (Makkah) 1976 and others such as Resolution of the Fiqh Academy of OIC 1985, Resolution 12/11 of Al Barakah Group Symposium and etc.

3. TAKAFUL AND ITS MODELS

Most of the researchers such as (Salman and Htay, 2014; Arifin et al, 2013; Alhabshi *et al.*, 2012Archer, Karim, &Nienhaus, 2011; Jaffer et al., 2010; Othman & Abdul Hamid, 2009;).mention that the practice of Takaful can be traced back to Prophet's time. At that period of time, Prophet approved the practice of *Aqilah*where the immediate family of the victim is paid by the family of the killer in order to help the victim's family. This type of voluntary donation and contribution is encouraged in Islam since it helps the people who are facing misfortune. Although the practice of *Aqilah* is a good practice and it is allowed in Islam, this practice is borrowed by Takaful operators formally after conventional insurance has been announced as non-Shari'ah complaint product and Takaful has been introduced as an alternative to it. Takaful has been based on the concept of mutual contribution among the participants in order to help among them in the case of misfortune. In order to have a binding contract between Takaful operators and participants, Shari'ah advisors have come out with several Takaful models. In this paper, seven Takaful models are discussed.

In Cooperative (*Taa'wuni*) Model, when Takaful operators receive the contribution from the participants, it will be kept in the participant risk fund (PRF). This fund will be used to invest in the Shari'ah compliant investment in order to generate the income and it will be monitored by the Takaful operators. All the expenses will be paid out of it and surplus will be shared between shareholders and participants. In the case of deficit in this fund, shareholders are obliged to lend the interest free loan to PRF (Frenz&Soualhi, 2010; Htay et al, 2012).

Under **Pure *Wakalah* (Agency) Model**, there is an agency relationship between the Takaful operators and participants. Takaful operators are behaving as agents by managing and making the investment of Takaful funds on behalf of the participants. For this service, Takaful operators are paid the Wakalah fee (agency fee). When the contribution is received, it will be split into agency fee, participant risk fund (PRF) and participant investment fund (PIF). The only income for the Takaful operators is agency fee. In the case of shortage in the risk fund, shareholders are required to provide the interest free loan (Frenz&Soualhi, 2010; Htay et al, 2012).

In the **Modified Wakalah Model (*Wakalah* with Incentive Compensation),** the contractual relation between TOs and participant is still agency relationship with the additional feature in this model is TOs can share the surplus from PRF. Once contribution is received, it will be split into three funds, namely, agency fee, PRF and PIF. The purpose of this model is to encourage the TOs perform better by giving the facility of surplus distribution as incentive. Shareholders are obliged to lend the interest free loan if there is any deficit in PRF (Frenz & Soualhi, 2010; Htay *et al.*, 2012).

In the case of **Pure *Mudarabah* (Investment Profit-Sharing) Model,** TOs are the entrepreneur and participants are capital providers and their relationship is based on the profit sharing concept. The contribution paid by the participants is allocated into two accounts, i.e. PRF and PIF. TOs are not receiving the agency fee and only income for them is the profit share from PIF. If there is any deficit in the PRF, the shareholders are supposed to lend the interest free loan (Frenz&Soualhi, 2010; Htay *et al.*, 2012).

Under **Modified *Mudarabah*Model,** TOs can deduct some expenses before calculating the surplus or deficit. In addition, they can share the surplus from PRF and get profit from PIF. Hence, contribution will be allocated into PRF, PIF and management expenses charged by TOs. When there is a deficit in PRF, it will be covered by the interest free loan provided by the shareholders (Frenz&Soualhi, 2010; Htay *et al.*, 2012).

Hybrid *Wakalah-Mudarabah* Model comprises the concepts of ofWakalah and Mudarabah. Contribution will be allocated into 3 accounts, namely, PRF, PIF and Wakalah fee. TOs have three types of income and they are Wakalah fee, surplus sharing from PRF and investment profit share from PIF. Similar to other models, deficit will be covered by providing the interest free loan from the shareholders (Frenz & Soualhi, 2010; Htay *et al.*, 2012).

In ***Waqf* Model**, the shareholders need to start some capital in PRF to start the waqf. Other than the initial donation as waqf, the rest will be similar to the Hybrid *Wakalah-Mudarabah* model (Frenz & Soualhi, 2010; Htay *et al.*, 2012).

4. COMPARISON AMONG TAKAFUL MODELS

A comparison among seven Takaful models in terms of splitting the participant contribution, payment for Re-Takaful contribution and reserves, operating expenses, surplus sharing, profit sharing from the PIF, claims, surrender, maturity and interest free loancan be referred to the following table.

Comparison among Seven *Takaful* Models

Splitting Participant Contribution

No.	*Takaful Model*	*Wakalahfee (WF)*	*Participant Risk Fund (PRF)*	*Participant Investment Fund(PIF)*
1	Cooperative (*Taa'wuni*) Model	-	✓	-
2	Pure *Wakalah* (agency) Model	✓	✓	✓
3	Modified*Wakalah* Model	✓	✓	✓
4	Pure *Mudarabah* Model	-	✓	✓
5	Modified *Mudarabah* Model	-*	✓	✓
6	Hybrid *Wakalah-Mudarabah* Model	✓	✓	✓
7	*Waqf* Model	✓	✓	✓

***ReTakaful*Contribution and Reserves**

No.	*Takaful Model*	*Wakalah Fee*	*PRF*	*PIF*
1	Cooperative (*Taa'wuni*) Model	-	✓	-
2	Pure *Wakalah* (agency) Model	-	✓	-
3	Modified*Wakalah* Model	-	✓	-
4	Pure *Mudarabah* Model	-	✓	-
5	Modified *Mudarabah* Model	-	—	-
6	Hybrid *Wakalah - Mudarabah* Model	-	—	-
7	*Waqf* Model	-	✓	-

Payment for operating Expenses including the commission

No.	*Takaful Model*	*WakalahFee*	*PRF*	*PIF*
1	Cooperative (*Taa'wuni*) Model	-	—	-
2	Pure *Wakalah* (agency) Model	✓	-	-
3	Modified*Wakalah* Model	✓	-	-
4	Pure *Mudarabah* Model	-	✓	-
5	Modified *Mudarabah* Model	-*	-	-
6	Hybrid *Wakalah-Mudarabah* Model	—	-	-
7	*Waqf* Model	✓	-	-

Surplus (Participant Risk Fund) sharing

No.	*Takaful Model*	*Partici-pants*	*Takaful Operator*
1	Cooperative (*Taa'wuni*) Model	—	—
2	Pure *Wakalah* (agency) Model	—	-
3	Modified*Wakalah* Model	—	—
4	Pure *Mudarabah* Model	—	-
5	Modified *Mudarabah* Model	—	—
6	Hybrid *Wakalah-Mudarabah* Model	—	—
7	*Waqf* Model	—	—

contd. table

Profit sharing from Participant Investment Fund

No.	*Takaful Model*	*Participants*	*TO*
1	Cooperative (*Taa'wuni*) Model	-	-
2	Pure *Wakalah* (agency) Model	✓	-
3	Modified*Wakalah* Model	✓	✓
4	Pure *Mudarabah* Model	–	–
5	Modified *Mudarabah* Model	–	–
6	Hybrid *Wakalah-Mudarabah* Model	–	–
7	*Waqf* Model	–	–

Payment for claims

No.	*Takaful Model*	*PRF*	*PIF*
1	Cooperative (*Taa'wuni*) Model	–	-
2	Pure *Wakalah* (agency) Model	–	-
3	Modified*Wakalah* Model	–	-
4	Pure *Mudarabah* Model	–	-
5	Modified *Mudarabah* Model	–	-
6	Hybrid *Wakalah-Mudarabah* Model	–	-
7	*Waqf* Model	✓	-

Payment for surrender

No.	*Takaful Model*	*PRF*	*PIF*
1	Cooperative (*Taa'wuni*) Model	–	–
2	Pure *Wakalah* (agency) Model	–	–
3	Modified*Wakalah* Model	–	–
4	Pure *Mudarabah* Model	✓	✓
5	Modified *Mudarabah* Model	–	–
6	Hybrid *Wakalah-Mudarabah* Model	–	–
7	*Waqf* Model	–	–

Payment for maturity

No.	*Takaful Model*	*PRF*	*PIF*
1	Cooperative (*Taa'wuni*) Model	–	–
2	Pure *Wakalah* (agency) Model	–	–
3	Modified*Wakalah* Model	–	–
4	Pure *Mudarabah* Model	✓	✓
5	Modified *Mudarabah* Model	–	–
6	Hybrid *Wakalah-Mudarabah* Model	–	–
7	*Waqf* Model	–	–

Entitlement to receive interest free loan

No.	*Takaful Model*	*Yes*	*No*
1	Cooperative (*Taa'wuni*) Model	✓	-
2	Pure *Wakalah* (agency) Model	✓	-
3	Modified*Wakalah* Model	✓	-
4	Pure *Mudarabah* Model	✓	-
5	Modified *Mudarabah* Model	✓	-
6	Hybrid *Wakalah-Mudarabah* Model	✓	-
7	*Waqf* Model	–	-

Note: * TOs are allowed to charge the direct cost of handling claims and management expenses

When the TOs receive the contribution from the participants, the contribution amount will be split into *Wakalah* fee (WF), PRF and PIF for Pure *Wakalah* model, Modified *Wakalah*model, Hybrid *Wakalah-Mudarabah* model and *Waqf* model. In the case of Cooperative model, all the contribution will be in PRF only. For Pure *Mudarabah* model and Modified *Mudarabah* model, the contribution will be allocated in PRF and PIF. However, in the Modified *Mudarabah* model, the TOs are allowed to charge the direct cost of handling claims and management expenses.

Regarding the payment for Re-Takaful contribution and allocation for reserves, it will be given out of PRF under all Takaful models. To pay the operating expenses, Cooperative model and Pure Mudarabah model use PRF while Pure *Wakalah* model, Modified *Wakalah* model, Hybrid *Wakalah-Mudarabah* model and *Waqf* model use WF. Modified *Wakalah* model is allowed to use part of the contribution to pay for operating expenses.

All the Takaful models except the Pure *Wakalah*model and Pure *Mudarabah* model allow sharing the surplus between participants and TOs. Under these two models, surplus will be distributed back to the participants. For sharing of profit from PIF, five Takaful models, namely Modified *Wakalah* Model, Pure *Mudarabah* Model, Modified *Mudarabah* Model, Hybrid *Wakalah-Mudarabah*Model and *Waqf* Model, allow to share between participants and TOs. In the Pure *Wakalah* (agency) Model, all the profit belongs to the participants only and in the Cooperative model, there is no PIF.

In all models, the claims are paid out of PRF. For surrender and maturity, PRF will be used and the respective portion in PIF including the profit portion will be received by the participants. In every Takaful model, it is compulsory for TOs to provide the interest free loan if necessary.

4. CONCLUSION

This paper explains why insurance is prohibited from the Islamic perspective and discusses about Takaful and its various models. This paper presents the comparison among seven *Takaful* models. There are some variation among the models in terms of allocating contribution, payment for operating expenses including the commission, surplus and profit sharing. However, the rest such as R*e Takaful* contribution and reserves, payment for claims, surrender, maturity and entitlement for receiving interest free loan are the same in all models. It is expected that the findings of this paper can be used for future development of new models.

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