

A Glance on Shariah Basis of Takaful (Islamic Insurance)

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Abstract: This is a doctrinal research on the Shariah basis of takaful (Islamic Insurance). The research reveals that that takaful has basis in ancient Arabia in the system of “Aqilah” which involves mutual assistance. It can also be traced down in the Sunnah of the Holy Prophet (peace and blessings of Allah upon him) and also his companions. Moreover, a study of the primary sources for Muslims (i.e. the Qur’an and the Sunnah), indicates that members of the first Islamic community effectively applied systems of cooperative risk sharing, long before the beginning of takaful practices. Additionally, in takaful, contributions (premiums) are paid on donation (tabarru) basis, thus the element of gharar is totally avoided. Again, takaful is based on various transactions accepted by the Shariah. Essentially, the contemporary Islamic scholars mentioned that Mudarabah or wakalah or waqf or a combination of the three models is the most appropriate Islamic contracts which should be employed in managing takaful business. Furthermore, Islam does not prohibit accepting a good opinion from others, if it proves to be beneficial. Moreover, takaful shares same philosophy with insurance which is mutual cooperation between members for the sake of mutual cooperation and protection. The idea has been realized from the understanding of how Allah wants Muslims to cooperate in achieving the Ummah’s interest. Takaful is an example of how Islamic Shariah can help to improve welfare of the Ummah and create new socio-economic mechanism based on equity, justice and fair play.

Keywords: Insurance, takaful, tabarru (donation), Aqilah, takaful benefits

INTRODUCTION

Takaful is the Islamic alternative to insurance of the conventional system. When we look into the primary sources for Muslims (i.e. the Qur’an and the Sunnah), we find traces that indicates that members of the first Islamic community efficiently applied systems of cooperative risk sharing, since before the beginning of takaful practices. In the initial growth of Muslim community in Medina (1-20 AH), at least in three instances the Holy Prophet (peace and blessings of Allah upon him) applied an insurance scheme to resolve daily issues. For example, constitution of Medina involves codified references to social insurance through some practices such as diya and Aqilah (wergild or blood-money to free an accused in accidental killings), fitya (ransom of prisoners of war) and cooperative schemes to help the needy, ill and poor.

Moreover, Islamic insurance or takaful is not different in its philosophy with insurance as it is an idea that focuses on mutual cooperation between members in order to secure their mutual protection. The idea has been deduced from the understanding of how Allah wants Muslims to cooperate in achieving the Ummah’s interest. Takaful is an example of how Islamic Shariah can help to improve welfare of the Ummah and create

new socio-economic mechanism based on equity, justice and fair play.

Again *takaful* is based on various transactions accepted by the Shariah. Participants in the takaful scheme give contributions and the takaful operator manage the business depending on the kind of Shariah contract they decided to choose.

Thus, this research will elaborate more on the Shariah basis of takaful.

History

Takaful has basis in ancient Arabia in the system of “Aqilah” which involves mutual assistance. It can also be traced down in the Sunnah of the Holy Prophet (peace and blessings of Allah upon him) and also his companions [1].

A study of the primary sources for Muslims (i.e. the Qur’an and the Sunnah), indicates that members of the first Islamic community effectively applied systems of cooperative risk sharing, long before the beginning of *takaful* practices. In the initial growth of Muslim community in Medina (1-20 AH), at least in three instances the Holy Prophet (peace and blessings of

Allah upon him) applied an insurance scheme to resolve daily issues. For example, constitution of Medina involves codified references to social insurance through some practices such as *diya* and *Aqilah* (wergild or blood-money to free an accused in accidental killings), *fidya* (ransom of prisoners of war) and cooperative schemes to help the needy, ill and poor [2].

Philosophy

Islamic insurance or *Takaful* is not different in its philosophy with insurance as it is an idea that focuses on mutual cooperation between members in order to secure their mutual protection. The idea has been deduced from the understanding of how Allah wants Muslims to cooperate in achieving the Ummah's interest. *Takaful* is an example of how Islamic Shariah can help to improve welfare of the Ummah and create new socio-economic mechanism based on equity, justice and fair play [3].

Takaful system assists in the formation of individual household. The premiums paid by the participants can be invested for the economic development and social welfare project of the community. Like life insurance, family *takaful* also aims at creating an instant estate in the event of the death of breadwinner of the family. Apparently, this seems to be the only instrument available for the Muslims looking at the fact that the Islamic system is not adopted in totality in this modern world. The Shariah encourages one to leave his family rich instead of leaving them poor asking help from others. Thus, to have a life insurance policy does not mean insuring one's life as many people look at it, but it is just a financial transaction that ensures benefits to some weak people in the society. It is considered as a mechanism of providing a financial safeguarding and security for the off-springs, widow and other dependents of the deceased and hence does not contravene the teachings of Islam [4]. The following hadith of the Holy Prophet (Peace and blessings of Allah be upon Him) is a clear illustration to that effect:

Narrated Sa'ad Ibn Abi Waqqas (RA): "I was stricken by an ailment that led me to the verge of death. The Prophet (Peace and blessings of Allah be upon Him) came to pay me a visit. I said, "O Allah's Apostle! I have much property and no heir except my single daughter. Shall I give two-thirds of my property in charity?" He said, "No." I said, "Half of it?" He said, "No." I said, "One-third of it?" He said, "You may do so, though one-third is also too much, for it is better for you to leave your offspring wealthy than to leave them poor, asking others for help..." [5].

Based on the above hadith, it is not correct to claim that purchasing an insurance policy, especially life is against the principle of *Tawakkal* [6]. This statement is not correct as purchasing an insurance policy is just a mutual transaction where parties involved in the transaction agree to work for a welfare or protection of the insured in case of occurrence of an unexpected loss or damage. The Prophet (Peace and blessings of Allah be upon Him) strongly disapproved begging to the extent that He admonished not to ask for even the *Miswak* (the tooth stick) or a shoe lace from any one [7]. Therefore, it is submitted that the above hadith, despite the fact that is not directly related to insurance or *takaful* but is significantly relevant as it explains certain points relied on to establish the impermissibility of insurance by some. The following are some of these points:

- Nowhere in the hadith where the Prophet (Peace and blessings of Allah be upon Him) mentioned to Sa'ad that leaving wealth for his daughter is against *Tawakkal*. If the argument of lack of *tawakkal* is correct, the Prophet (Peace and blessings of Allah be upon Him) could have advised Sa'ad that leaving wealth for your daughter is against *Tawakkal*, but He did not;
- The Prophet (Peace and blessings of Allah be upon Him) clearly informed Sa'ad that leaving his offspring wealthy is better than to leave them poor asking others for assistance and help; and
- Even though, Sa'ad has only one daughter, the Prophet (Peace and blessings of Allah be upon Him) advised Sa'ad to leave for her a huge amount of money, and that indicates that leaving your offspring with a big financial capability is encouraged by Islam.

The history of the war of *Khandaq* (Trench) is another instance to be reckoned with in this regard. The Prophet (Peace and blessings of Allah be upon Him) accepted a new idea put forward by Salman Farisi, despite being a Persian idea which goes to show that Islam accepts benefitting from experiences of other nations, even if they were to be pagans. Thus, providing new ideas that bring benefits to the Ummah is always welcomed, so long as they are in line with the Shariah [8].

Likewise, Islam does not prohibit accepting a good opinion from others, if it proves to be beneficial. For example, during the battle of *Badr*, the Prophet (Peace and blessings of Allah be upon Him) accepted and applied the opinion of one of his companions. During that battle, the Prophet (Peace and blessings of Allah be upon Him) initially decided to camp at a certain place, but Hubab Ibn al-Mundhir al-Khazraji asked Him whether the said decision was a directive of

Allah (May He be exalted) or just an opinion and strategy of war. After the Prophet (Peace and blessings of Allah be upon Him) replied that: it was just an opinion and strategy of war, the companion proposed another place as he believed the initial place was not the right place to halt as a strategy of war. The Prophet (Peace and blessings of Allah be upon Him) accepted the idea and implemented it [9].

Moreover, risk management technique is encouraged by Islam and undoubtedly *takaful* should fall within its ambit. The Holy Qur'an narrated the decision taken by *Ya'qub (AS)* of telling his sons not to enter through one gate when they were about to leave for Egypt in search of food for their families, where this decision by *Yaqub (AS)* shows risk diversification whose aim was to reduce the probability of loss. In the same *Surah*, it was revealed how Prophet *Yusuf (AS)* implemented fifteen years economic plan as a form of risk reduction. The lessons from this *Surah* are not only confined to lessons in fate and faith but also there are abundant lessons related to financial planning [10].

Thus, it is strongly submitted that planning is the actual putting someone's trust in Allah regardless of whether or not the plan is successful. This is because a human being is only required to plan, but has no power in the outcome of that particular plan. Looking at the above history of Prophet *Yaqub (AS)* and his sons, He stated clearly that what He told them was just His idea (which was "planning") as precautionary measures just to avert the fear in His heart, but did not profit them in the least against (the plan of) Allah. In the same *Surah* where the above history was mentioned, Allah (May He be exalted) told us how *Yusuf (AS)* implemented a plan that ultimately saved the then people of Egypt from the famine. Allah (May He be exalted) said:

He (Yusuf) said: You shall sow for seven years continuously, then what you reap leave it in its ear except a little of which you eat. Then there shall come after that seven years of hardship which shall eat away all that you have beforehand laid up in store for them, except a little of what you shall have preserved. Then there will come after that a year in which people shall have rain and in which they shall press (grapes) (Al-Qur'an, Yusuf, 12:47-49).

The above verses indicate that an individual or society needs to plan when confronted with the certainty of a vital event. The verses showed that *Yusuf (AS)*' plans was implemented by the then king of Egypt which eventually enabled the society to survive the hardship of the famine. Thus, it is submitted that a person who participates in a family *takaful* business as a financial planning to provide for his family after his demise would not be regarded as not having trust in

Allah (May He be exalted), because one of the lessons to be taken from the above verse is that if planning for an event that is certain to occur in the future is against putting trust in Allah, *Yusuf (AS)* would not have taken any necessary measures to save Egypt from the famine, but would have said Allah is there for me and will definitely save Egypt from that unfortunate event. Furthermore, the Holy Prophet (SAW) told a Bedouin Arab who left his camel untied trusting to the Will of Allah (SWT) – "Tie the camel first then leave it to Allah (SWT) [11].

Shariah Contracts

Family *takaful* is a contract that protects individuals against any financial loss that may occur as a result of death. It aims at administering a form of uncertainty known as pure risk. Pure risk is present where there is no potential gain, but only possibility of loss. The role played by the *takaful* operators is sharing the risk with the participants besides allowing other members to participate in the scheme so as to share the risk and help ease the burden of the family that resulted from the death of the participant [12].

Additionally, in *takaful*, contributions (premiums) are paid on donation (*tabarru*) basis, thus the element of *gharar* is totally avoided. According to *Maliki* School of law, *gharar* has no effect on gratuitous contracts [13]. The contribution in the contract is a monetary consideration given by the participants. The consideration in the contract is required from both the operator and the participant because it is a contract of mutual cooperation. The operator is unilaterally bound by the contract. Moreover, it is the duty of the participants to give their own consideration because it is an obligation in Islam to settle the respective considerations in a transaction of mutual cooperation [12].

Likewise, *takaful* contracts are based on divine principles of mutual cooperation and solidarity between the participants themselves and the operator. *Takaful* contracts are free from usury (*riba*) [12]. The Islamic insurance companies generally invest in Shariah compliant products and governments of Muslim majority countries normally introduce a legal framework which helps in introducing new compliant products [14]. The funds in Islamic insurance are invested in securities that are free from interest [15]. Again, *takaful* fund is managed by operator but the actual owners of the fund are the participants who are the contributors and beneficiaries as well [16].

Moreover, *takaful* is based on various transactions accepted by the Shariah. Essentially, the contemporary Islamic scholars mentioned that *Mudarabah* or *wakalah* or *waqf* [17] or a combination of the three models is the most appropriate Islamic

contracts which should be employed in managing *takaful* business [18]. The contract of *ju'ala* has also been suggested as more suitable to be applied by *takaful* operators in order to defend their entitlement to performance-related fees (mainly upon getting a PRF surplus) provided that all of its specifications are carefully observed [19].

The contract of *Mudarabah* (trustee profit-sharing) is defined as a contractual agreement between the *Rabbul mal* (capital provider) and the *mudarib* (entrepreneur) for the business venture, whereby both parties agree on a ratio of pre-determined profit-sharing, and losses in the business venture is the sole responsibility of the *Rabbul mal* (capital provider) except where the losses are caused by the misconduct, negligence, violation of conditions by the entrepreneur [20]. If *al-mudarabah* is applied to the *takaful* contract, the *takaful* operator is considered as the entrepreneur who has the responsibility of carrying out the *takaful* business activities, where the participants as capital providers (*Rabbul mal*) donate the funds to the *takaful* operator. Generally, the contract normally specifies the proportion of profit (surplus) to be shared between the participants and the *takaful* operator [21].

Regarding *Wakalah*, The word is a noun derived from the term '*wakalah*' which indicates performing an act on behalf of others, or delegation of a job or task to another [18]. According to AAOIFI Shariah Standard No. 23, *wakalah* is "the act of one party delegating the other to act on its behalf in what can be the subject matter of the delegation" [22]. Thus, where the *wakalah* model is applied, the operator (*wakil*) will manage the *takaful* fund as an agent of the participants where he will be given an upfront fee (*Ajr*) for his services. Any profit gained from the management of the *takaful* fund is entirely owned by the participants, and in case of loss, it has to be borne by the participants as well, unless where the losses is caused by the negligence or misconduct of the *takaful* operator [18].

As regards *Waqf*, it literally means 'detention, but, its legal meaning refers to 'the dedication of a property or to donate it in charity for a moral religious or charitable purpose [18]. Where *waqf* is made, the right of the *waqif* (dedicator) has been completely taken away and ownership is transferred to Allah (swt) [23]. In *Waqf* model, that is preferred by Mohammad Taqi Usmani as he believes it is purely Islamic [17], the *takaful* operator will establish a *waqf* account from the *takaful* fund. Here, the operator will separate some money as *waqf* so as to operate the said *waqf* fund. The *waqf* fund shall be used to provide financial assistance to the members in case of losses and the benefits is given strictly based on the *Waqf* Deed. All expenses together with underwriting and operational cost of the

takaful are to be charged to the *waqf* fund. The *takaful* operator, as the manager will carry out all necessary functions for the operations of the *waqf* for a *Wakalah* fee which should be deducted from the contribution donated by the participants [18].

On the other hand, the hybrid model is a combination of *mudarabah* and *wakalah*. In this model the operator will receive the agency fee as upfront charges from the *takaful* fund and will also get share of the profit produced from the investment of the *takaful* fund based on the *mudarabah* contract [18].

With regard to *Ju'ala*, it literally means a reward given to someone for a work he or she has done. And technically, it is defined as an undertaken by a person to give an identified reward to another for a work he has done for him either within a specified time frame or so long as it provides benefit to another [19]. According to AAOIFI in its Shariah Standard No (1) defines *ju'ala* as "a contract where one of the parties (the *ja'il*) offers specified compensation (the *ju'l*) to anyone (the *Amil*) who achieves a determined result in a known or unknown period [22]. In this model, it has been suggested that a portion of the surplus distributable to the operators is considered as an incentive or reward from the participants for the effort put in registering a surplus to the PRF [19].

CONCLUSION

It is found that *takaful* has basis in ancient Arabia in the system of "*Aqilah*" which involves mutual assistance. It can also be traced down in the Sunnah of the Holy Prophet (peace and blessings of Allah upon him) and also his companions. Moreover, a study of the primary sources for Muslims (i.e. the Qur'an and the Sunnah), indicates that members of the first Islamic community effectively applied systems of cooperative risk sharing, long before the beginning of *takaful* practices. Additionally, in *takaful*, contributions (premiums) are paid on donation (*tabarru*) basis, thus the element of *gharar* is totally avoided. Again, *takaful* is based on various transactions accepted by the Shariah. Essentially, the contemporary Islamic scholars mentioned that *Mudarabah* or *wakalah* or *waqf* or a combination of the three models is the most appropriate Islamic contracts which should be employed in managing *takaful* business. Furthermore, Islam does not prohibit accepting a good opinion from others, if it proves to be beneficial.

Moreover, *takaful* shares same philosophy with insurance which is mutual cooperation between members for the sake of mutual cooperation and protection. The idea has been realized from the understanding of how Allah wants Muslims to cooperate in achieving the Ummah's interest. *Takaful* is an example of how Islamic Shariah can help to improve

welfare of the Ummah and create new socio-economic mechanism based on equity, justice and fair play.

Furthermore, *takaful* business is conducted based on various Shariah contracts where participants give their contributions to form the *takaful* pool and engage the services of the *takaful* operator to manage the business depending on the kind of Shariah contract they decided to select.

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