

Comparative Study of Insurance and *Takafol* (Islamic Insurance)

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I. INTRODUCTION

Ibn Abidin (1784–1836) was the first scholar in the Muslim world to discuss the meaning and legal character of insurance.¹ Islamicity of insurance has been under discussion since then. Opinions regarding legitimacy, adoption, and adaptability of insurance are numerous. Recently, however, a consensus was emerging for adapting insurance in the name of *takafol* and solidarity. As a result, several Islamic *takafols* and solidarity companies have been established since 1979.

During the last decade the Council of Islamic Ideology Pakistan (CIIP) reviewed the operations of the existing *takafols* in order to find a suitable model for Pakistan.² While declaring all of them incompatible with the injunctions of Islam, the CIIP proposed its own model of *takafol*, instead. Its rejection of existing *takafols* is a little paradoxical since the operations of all the *takafols* are claimed to be compatible with the *Shariah*. Each *takafol* guarantees *Shariah* compatibility of its operations by subjecting itself to the dictates of a *Shariah* Supervisory Board, which are empowered to review the company's practices, contracts, transactions and operations. This paper attempts to delineate the points of contact and convergence between insurance and *takafol*, and to make recommendations for possible improvement in the *takafol* concept. The study is organised as follows: Islamic debate on insurance, with special reference to its application to *takafols*, is reviewed in Section II. Pertinent operational features of *takafols* are compared with insurance in Section III. The CIIP model is examined in Section IV. The final section features proposals meant to augment the conformity of *takafol* with the principles of *Shariah*.

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¹See Klingmuller, "Concept and Development of Insurance in Islamic Countries", *Islamic Culture* (Hyderabad), January 1969, p. 30.

²See Council of Islamic Ideology, Pakistan, "Report on Islamic Insurance" [Report Islami Nizam Bima], June 1992, pp. 192–98.

II. ISLAMICITY OF INSURANCE

Insurance is an exchange contract. Ibn Abidin rejected it as it did not fit in the exchange contracts known in Islam. The first phase of acceptance of insurance took place when the so-called Modernists became the trend-setters for Muslim society, particularly under the leadership of Muhammad Abduh. A series of attempts were made to insert insurance into permitted contracts and to prove its legality.³ A correspondent of *Pakistan and Gulf Economists* cites *fatawa* (religious rulings) of prominent *ulema* (Islamic scholars) of different *mazahib* (Islamic schools of thought)⁴ generally favouring insurance, and refuting the presence of *riba* (usury and interest), *mai'sar* (gambling) and *gharar* (indeterminacy) therein. Another survey of *fatawa* for and against the contract of insurance issued up to 1965 is given in Muslehuddin.⁵

In its 1972 meeting the Islamic Studies Conference (ISC) considered eighty opinions on insurance submitted by scholars worldwide, but adjourned without making final recommendations, leaving the topic pending for further study.⁶ Interestingly, *fuqaha* have seldom given unanimous recommendations on the issue of insurance. For instance, recommendations of the *Majlis Fiqhi Islami* were dissented by Sheikh Mustafa Zarqa and of CIIP were dissented by Abdul Malik Irfani.⁷

Positions taken by scholars on insurance differ depending on their views regarding presence of *gharar*, *riba*, and gambling in insurance contracts. Gambling and *riba* are condemned in the Qur'an while condemnation of *gharar* is supported by *mutwatir* (chained) *Ahadith* (Prophet's rulings).⁸

Insurance is blamed for *gharar* because, at the time of the contract, the insured are uncertain about (i) occurrence of indemnity, (ii) amount accrued in case of indemnity, and (iii) the timing of indemnity. But supporters of insurance argue that these matters are unknown only at the individual level, while at the

³See E. Klingmuller, *ibid*, p. 34.

⁴See a correspondent, "Is Insurance Islamic?", *Pakistan and Gulf Economist*, Feb. 23-March 1, 1985, pp. 35-36.

⁵See Mohammad Muslehuddin, *Insurance and Islamic Law*, Lahore: Islamic Publications, 1979, Third Edition, pp. 143-165.

⁶See Faisal Islamic Bank Sudan, *Rules of the Shariah Supervisory Board*, n.d. p. 14.

⁷See CIIP (1992), *ibid*, pp. 180-183.

⁸Refer to al-Baqarah: 275-282 for prohibition of *riba* and al-Baqarah: 219 for prohibition of *mai'sar*, *Gharar* is based on *mutwatir* *ahadith*. For instance, Abu Huraira reported that Holy Prophet (PBUH) forbade the sale by stone throwing and the sale of al-Gharar [Muslim]. Ali reported that the Messenger of Allah forbade forced purchase from a needy person, and purchase of al-Gharar and purchase of fruit before it reaches maturity [Abu Daud] Refer to Mohamed Sadik, "Islamic Insurance System as Practised by the Islamic Insurance Company Ltd. (Sudan)", n.d. pp. 3-4.

collective level, they are scientifically determined by statistical laws of large numbers, actuary and probability. It would not be proper to prohibit it due to *gharar* at the individual level.⁹

Gharar inherent in the contract of insurance is condoned under the doctrines of *darura* (necessity) and *masalahah* (public interest). Siddiqi¹⁰ emphasises that the present system of wealth creation and the present level of civilisation is simply inconceivable without recourse to insurance. Insurance is important, he argues, for the smooth flow of business activity and production processes; large-scale supply of capital; availability of goods requiring a long production period; and reduction in cost of goods. Others argue that insurance is a hedging against misfortunes through personal means rather than relying on the public means or family support, which may not be realised.¹¹

Insurance is declared *mai'sar* because the policy holders are seen to bet premiums on the condition that the insurer will make payment (indemnity) on the happening of a specified event. The advocates of insurance argue that insurance is the contract of indemnity,¹² which is altogether different from gambling. A specified event must occur by the appointed time and one of the parties must win or lose in gambling. In the case of insurance, the specified event may or may not happen during the policy period. But the indeterminacy of event used to disclaim gambling can be cited as a reason for *gharar*. Moreover, the insured holds a specific financial interest, called insurable interest, in the subject-matter of insurance. He is entitled to compensation only if he suffers any loss or damage and indemnity is limited to the actual loss or damage. In gambling, the parties have no other interest than the sum to be won or lost by the determination of an event. They further argue that the act of gambling creates a new risk while insurance tries to manage inherent, though predictable, risks to make losses bearable to the individuals susceptible to such risks. The risk of financial loss courted by a gambler can be avoided if desired, but the inherent risks cannot be avoided. Insured persons seek protection against the financial loss which may result from such risks.¹³

⁹See M. N. Siddiqi, *Insurance in an Islamic Economy*. Leicester: Islamic Foundation, 1985, p. 42.

¹⁰See Siddiqi, *ibid*, p. 25.

¹¹Raquibuz Zaman, *ibid*, pp. 264-66.

¹²Every insurance contract is not subject to the principle of indemnity. For instance, insurances covering human life (i.e. life, personal accident and sickness policies) are excluded from the principle of indemnity as they are not capable of pecuniary valuation. Similarly, valued policies are not contracts of indemnity and, therefore, the possibility of gambling cannot be eliminated from the valued insurance.

¹³See Raquibuz Zaman, "Some Issues in Risk Management and Insurance in a Non-Muslim State". *American Journal of Islamic Social Sciences*, 5:2, p. 267; and Siddiqi, *ibid*, pp. 27-35.

Riba refers to transactions involving unequal exchange of the same thing. Insurance is viewed as unequal exchange of money in premiums and compensations. In fact, money paid in premiums, never equals the money received in indemnity. The insured receives less or nothing, as the case may be, in exchange of the premium when (i) he withdraws the policy, (ii) defaults on premiums, (iii) does not experience peril deserving indemnity and (iv) the insurance contract is declared void due to any other reason. Moreover, compensation received from insurers may be far greater than the premiums if a peril strikes. So *riba* accrues to the insured if the indemnity is more than the premiums, and to the insurers when compensation is nil or falls short of premiums. Therefore insurance contract, interpreted as exchange of money, cannot be free from *riba*. Moreover, there is *riba* beyond the *riba* embedded in the insurance contracts since the premium is invested by insurers in interest-bearing securities.

The advocates of insurance argue that there is no *riba* in insurance because neither is the premium a loan nor compensation a returning of the loan with an incremental amount. The money received in claim by the insured neither depends on the elapsed period nor on the total money in the premium. The amount actually depends on the extent of financial loss incurred in consequence of a peril. Such increment is not *riba*.¹⁴

It is also argued that individuals engage in *riba* transactions with the sole purpose of monetary gains. Insurance is a systematic pooling of individual resources to cover collectively the expected inherent risks of loss that each and every member faces. The purpose of an insurance policy is to protect, not to enhance, the financial position of the insured.¹⁵

Insurance is also considered unlawful because the compensation is given to nominees, which is contrary to the Islamic laws of inheritance.

Qur'an¹⁶ ordains compensation including monetary benefits to the victim's family for killing someone by mistake. Therefore, in principle, there is no harm in obtaining monetary gains against the death of a family member which seemingly justifies conduct of life insurance. In fact, liability insurance covering compensation to victims of (say) accidents shall be made compulsory in Muslim countries to ensure compliance with the Qur'anic injunction, particularly when damage is done by the financially weak or runaway aggressors.

Insurance is also an essential part of banking and international trade transactions. For instance, banks do not negotiate the international bills of ex-

¹⁴See Siddiqi, *ibid*, p. 38.

¹⁵Raquiuz Zaman, *ibid*, p. 266.

¹⁶See Nisa'a: 92.

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¹³See Raquibuz Zaman, "Some Issues in Risk Management and Insurance in a Non-Muslim State". *American Journal of Islamic Social Sciences*, 5:2, p. 267; and Siddiqi, *ibid*, pp. 27–35.

change unless the goods are insured against Marine insurance and do not finance large industrial projects without an insurance arrangement.

Omar Farrukh argues that "insurance may be equated with an agreement between two parties in which one gives a guarantee to the other regarding some property in possession of the other against its perishing, undergoing startling degradation or deviating from its normal course of development... Islam... admits some aspects of this guarantee."¹⁷ Obviously, if insurance is viewed as a contract of guarantee, rather than an exchange of money, then it is absolved of contractual *riba*.

However, commercial insurance has been generally condemned while mutual insurance, organised as a private or a public venture, is commended.¹⁸ Commercial insurance is condemned because insurers are alleged to "profit out of the weakness of individual insurees".¹⁹ But, barring the profit motive, mutual and commercial insurance are not very different.²⁰ Profit-seeking activities are not prohibited in Islam. Moreover, insurance performs security functions similar to *zakah*, although to different categories of people. As managers of *zakah* are entitled to a remuneration from *zakah* fund then, in principle, the managers of insurance should not be denied profits for performing insurance services.

¹⁷See Omar Farrukh, "Banking and Insurance in relation to the Islamic Concept of Riba", p. 128.

¹⁸Commercial insurance, in all its forms, is declared *haram* (illegitimate) by the Majlis Fiqhi Islami at the Rabita Alami Islami, due to the presence of *gharar*, gambling, *riba*, the prohibited form of *rahn*, unequal exchange, and payment by the insurer on the happening of an injurious incidence in which insurer has no role. The Majlis Hitah Kibarul Ulema also declared all forms of commercial insurance, except cooperative insurance, *haram*. The Islamic Shariah Board of Dar al-Mal al-Islami is of the opinion that commercial insurance does not comply with Islamic rules. This was also the recommendation of the First Conference for Islamic Economy held in Mecca, in 1976. Some Muslims accept commercial insurance provided certain un-Islamic components are weeded out and insurance is reorganised as *takafol* on the basis of Islamic code of conduct. In fact, Syarikat Takaful Malaysia Sdn. Bhd. (STMSB) is established as a commercial enterprise operating in accordance with the principles of Shariah.

¹⁹See Afzalur Rahman, *ibid*, p. 186.

²⁰Commercial and mutual insurances are also distinguished on account of following reasons. In commercial insurance, losses are calculated in advance to be compensated by the carrier against which premium is charged. The insured has to pay definite amount in consideration of which the company undertakes losses that may result from the risks specified in the policy. Premium is fixed and the company has no right to demand more. The insured is thus a policy holder. He has no concern with the company which is a profit-seeking body.

The pure mutual institution is managed and controlled by the members alone who are its participants. The losses are shared by the members as they occur. Premium is not necessarily paid in money as it may consist of liability of contribution to the loss of other members. Prepayment, therefore, is not a condition precedent in this form of mutual insurance. Premium is on levy basis and, under the levy system, payment of amount is based on the actual losses and in case the collected amount should not cover the losses an additional sum may be demanded. For detailed discussion, refer to Muslehuddin, *ibid*, pp. 16-19 and Afzalur Rahman, *Banking and Insurance*, London: Muslim Schools Trust, 1979, pp. 182-242.

In a nutshell, insurance itself is not contrary to Islam. However, the conduct of insurance is suspect mainly on account of *gharar*, *riba* and gambling.

III. PRINCIPLES AND PRACTICES OF *TAKAFOLS*²¹

As noted above, all banks require insurance on their financing transactions. Success of Islamic banks has encouraged them to establish their own *takafols* which, among other things, lend greater credibility to their banking operations.

Takafol is an alternative form of insurance. Consequently many of the principles and practices of insurance equally apply to *takafol*. *Takafols* cover general as well as life insurance.

General *takafols* are short-term contracts for protection of potential material losses resulting from specified catastrophes. Participants' installments are called *tabaru* (donation) by STMSB (Syarikat *Takafol* Malaysia Sendirian Berhad) and *takafol* by other companies. Amount of *takafol* contributions varies, as in insurance, according to the value to the property to be covered under the general *takafol* scheme. Company invests the *tabaru* funds, and the profits accrued therefrom are allocated between the fund and the management on the basis of *mudaraba*. Indemnity is paid out of the *tabaru* fund. Operational costs including reinsurance costs and other reserves are also deducted from the *tabaru* fund. If the fund generates net surplus then, unlike insurance, surplus is shared between participants and the company. The STMSB and IAIC (Islamic Arab Insurance Company) pay surplus only to those participants who did not incur claims, but, IICS (Islamic Insurance Company Sudan) pays surplus to all participants. The IICS receives a share of profits if offered by the reinsurers and the participants are automatically elected to a policy holders committee if their premiums are above 1,000 Sudanese Pounds. The CIIP rejected the IAIC model because, in its view, all conditions of occidental insurance are retained under Islamic nomenclature.²² The IICS model was also rejected because of the distribution of surplus from the *takafol* fund.

²¹It is not possible to discuss details of each *takafol*. Therefore, general features of the *takafols*, as of insurance, are compared here. Operational information is extracted from following company documents: (1) Muhammad Fadzli Yusof, "Towards an Islamic System of Insurance", paper presented in one-day seminar on *Takafol* in Jakarta on 19.10.1993; (2) Islamic *Takafol* Company Luxembourg, "*Modaraba Al-Tadamon* – A Savings & *Takafol* Programme"; (3) Islamic Insurance Company Sudan, "*Islamic Modarabas* for Investment, Savings, and *Takafol*"; Islamic Investment Company of the Gulf, "*Islamic Solidarity Companies*"; and (4) "*Seventh Islamic Modaraba* for Investment, Savings and Solidarity among Muslims"; (5) Islamic Insurance Company Ltd. (Jeddah), "*Marine Insurance Policy* – (Cargo)"; and (6) Mohammed Sadik, "*Islamic Insurance System as Practised by the Islamic Insurance Company Ltd. (Sudan)*".

²²See CIIP (1992), *ibid*, p. 197.

According to the CIIP,²³ if the premium is considered debt then all principal amount must be returned and if it is considered investment then profits of some participants cannot be diverted in favour of others.

In sum, in case of general insurance, there is no substantive difference between *tabaru* and premium from the insured point of view as the entire contributions of the participants are treated *tabaru*, like premium in insurance. The contributions, like premium, depend on the value of the property to be covered. But, unlike insurance, *takafol* participants are entitled to surplus in the *tabaru* fund, if any.

Islamic life insurance is organised in the name of family *takafol* by the STMSB, Solidarity *Modarabas* by the IICG (Islamic Investment Company of the Gulf) and the ITCL (Islamic *Takafol* Company Luxembourg), and by the IICS. Premiums, unlike insurance, are determined by the participants themselves depending on their financial strength. Instalments paid by the participants are divided into *takafol*, also called *tabaru*, account and participants' *mudaraba* investment account by the STMSB, the ITCL and the ITCB (Islamic *Takafol* Company Bahrain). The proportion for *tabaru* fund, like insurance, is calculated on actuarial basis which varies according to the age and participation period of the participants. In the case of ITCL, 2.5 percent to 10 percent of instalments go to *takafol* fund and the balance goes to the *mudaraba* investment account of the participants.

Insurance benefits are paid from the *tabaru* fund. Participants pledge to make additional contributions if the *takafol* fund proves insufficient. However, in reality, companies prefer to carry such deficits forward till the *takafol* fund enjoys surplus. In the meanwhile, companies finance the deficits on the basis of interest-free loans.

All instalments of participants in the IICS and the IICG are treated *mudaraba* investments. The *takafol* fund is generated from the profits on the *modarabas*. Some companies issue renewable *modaraba* certificates of one year duration. In the case of IICG, each subscriber can participate in *mudaraba* till the age of 60 or death whichever comes first. Participants can buy multiple certificates. The certificates are non-negotiable and non-transferable instruments. The IICS and IICG pay *takafol* benefits, sometimes called solidarity benefits, from the *mudaraba* profits.

The actual operating expenses are charged from the *Mudaraba* account by the ITCL, IICG and the IICS. In the case of IICG and ITCL, an issue fee is charged to cover the management expenses partially. The IICS does not charge manage-

²³See CIIP (1992), *ibid*, p. 195.

ment expenses from the *mudaraba* accounts. Likewise, the STMSB pays operating expenditures from its own profits accrued from *takafols* and shareholders' fund.

Profits from the *mudaraba* investments are shared between the participants and the companies in pre-agreed ratios. The profits among the participants' account and *takafol* company are shared in the ratio 70:30 in STMSB, 80:20 in ITCL, and 90:10 in IICS.

Participants are entitled to reimbursements upon maturity, withdrawal and, in some cases, upon disablement. Upon death of a participant, his heirs are entitled to *takafol* benefits. The *takafol* benefits are reimbursed according to the Islamic inheritance laws. Benefits are payable to the nominees, in case of STMSB, as under insurance contracts because the nominees are considered trustees of the heirs of the deceased participants. If a participant lives till the maturity of the *takafol* contract, he is entitled to all his *mudaraba* investment including its profits. In addition, the STMSB pays net surplus from the *tabaru* account as well. The CIIP did not deliver any judgement on the STMSB due to lack of information. But the STMSB model will be disqualified on the same basis as the IAIC has been.

If a participant withdraws before the maturity of contract then the money in the investment account is paid as surrender benefits. However, participants may withdraw only after participating for a minimum of two years in the case of ITCL and IICG. In the case of IICG, withdrawing participants have to relinquish 5 percent of their account in consequence of a sudden withdrawal. This money is reinvested in favour of other participants.

If a member is disabled, the IICS waives future instalments and pays all the benefits to the disabled participants out of the *mudaraba* profits of the participants.

In the case of the death of a participant, his heirs are entitled to full value of the deceased participant's share in the *mudaraba* investment account plus money equal to all unpaid instalments, due to be paid in future if he lived, from the *takafol* account. In the case of the IICG, the solidarity benefits are paid only if not less than a year has elapsed, instalments were paid regularly, and no withdrawal request has been made.

In the case of family *takafol* in the STMSB, *tabaru* contribution varies, like the insurance premium, with the length as well as the maturity of the *takafol* plan. Calculation of *tabaru*, like premium, is based on the principles of actuary. The *takafol* companies satisfy themselves regarding the health condition of the clients. Instalments are to be paid in advance as premium. Participants can withdraw from the *takafol* schemes after a specified period, as in the case of insurance, but their contributions to *tabaru*, like the insurance premium, are forfeited.

Like insurance, *takafol* is concerned with uncertain future events which produce losses; and the special legal rules governing insurance contracts similarly apply to *takafol*. Participants cannot interfere with the management activities as the management assumes full authority. However, if a loss occurs due to disrespect of *modaraba* conditions, the *takafol* companies will bear those losses.

Takafol, like insurance, is based on the principles of insurable interest, indemnity, subrogation, and utmost good faith. The utmost good faith clause is required for the disclosure of all material facts, a condition commended in Islam. Unfortunately, insurers misuse it and try to avoid contracts. Subrogation entitles insurers to claim from a third party on behalf of the insured. Indemnity implies that a claim can be made only to the extent of actual financial loss to the insured. Indemnity and subrogation together ensure compliance with the requirements of insurable interest. Insurable interest itself ensures that a client can obtain insurance only if susceptible to loss for which insurance is sought.²⁴ *Takafol* companies perform entrepreneurial and managerial tasks. But management of *takafol* funds, unlike insurance premiums, is kept separate from the management of shareholders' funds. Even the rules to resolve *takafol* disputes are similar to those for insurance. All *takafol* companies have recourse to reinsurance companies. In insurance, any insurance surplus becomes profit of the company (shareholders) while *takafol* surplus is shared between the participants and the management (company) in the prescribed ratios.

Takafols do buy reinsurance, like the insurance companies, because existing *retakafol* companies are very few and too new for handling the entire *retakafol* needs of existing *takafol* companies. However, the *takafol* companies deal with them on a net basis in order to minimise their indulgence in *riba* practices of reinsurers.

In sum, *takafols* are different from insurance in several respects. *Takafol* differs from conventional insurance in the sense that the company manages and employs the funds for investment, business and administration on behalf of the participants. Profits attributed to the participants' funds are shared between the *takafol* company and the participants according to an agreed formula. In case of insurance, the premium funds become property of the company and any profits or losses go to the company's account.

The *takafols* need to invest funds in long-term as well as in short-term avenues to match their liquidity requirements. *Takafol* companies, unlike insurance, certainly face difficulties in making short-term investments on and interest-

²⁴See K. M. Mortuza Ali, "Insurance in Islam" *Thoughts on Economics*, 7:4, 1986.

free basis. Otherwise, the *takafols* and the insurance companies are at liberty to employ funds in projects of their choice. Therefore, one may conclude that the *takafol* companies primarily operate on similar lines as insurance companies although they may have to select only *halal* projects to meet *Shariah* requirements.

IV. COMPARISON OF CIIP MODEL AND EXISTING *TAKAFOLS*

The 1984 report of the CIIP maintains that premium is paid against an insured sum making the insurance contract an exchange contract. The insurance contracts contain prohibited elements including *gharar*, gambling and *riba*.²⁵ Therefore, "insurance in all its forms, except postal insurance in Pakistan, is wrong, wicked, unlawful, prohibited and unenforceable".²⁶

According to the CIIP 1984 report, cooperative insurance based on *tabaru*, *ta'awan*, *tadhaman*, and *takafol* containing, among others, the following characteristics would be lawful:²⁷ (i) when an insured is paid a certain sum at the happening of an incidence, the sum paid is considered *tabaru* from all the insured. In such cases, the presence of *gharar* is accepted, (ii) as cooperative insurance is not meant to receive profit so gambling and *riba* will not be present in it, and (iii) the insured are eligible for receiving *qard al-hasan* from the insurance fund. As pointed out earlier, the CIIP has also discarded existing *takafols* which are considered Islamic alternatives to insurance. The CIIP has recommended a *takafol* model which is claimed to be "in complete agreement with Islamic teachings".²⁸ But, there are striking similarities between the existing *takafols* and the model proposed by the CIIP. To avoid repetition of conditions discussed earlier, only the distinguishing features of the CIIP model are presented here.

The CIIP recommended that the *takafol* business shall be conducted by an autonomous, non-profit, state organisation. The *takafol* fund be established, as in other *takafols*, and it shall be a permanent fund, with the status of a *waqf*²⁹ (endowment). Instalments paid by the participants towards short-term general insurance will be added to the *takafol* fund. Instalments paid for long-term insurance plans will be divided into *modaraba* (or *musharakah*) investment and *takafol* contributions. Contributions of participants to the *takafol* fund shall be

²⁵See Council of Islamic Ideology, Pakistan, *Eleventh Report on Insurance and Laws of Insurance*, Islamabad, March 1984, p. 12.

²⁶See CIIP (1984), *ibid*, p. 12.

²⁷See CIIP (1984), *ibid*, p. 12.

²⁸See CIIP (1992), *ibid*, p. 173.

²⁹Idea to treat premiums as *waqf* was earlier proposed by Mufti Muhammad Shafi. See Muslehuddin, *ibid*, pp. 160-62.

non-refundable, although they shall be entitled to receive indemnity and compensation from the fund. Administrative expenses for the fund be covered from the profits on the *mudaraba* investments. It is also recommended that a specified percentage of the *takafol* fund be reserved for assistance of deserving non-participants.

The CIIP recommends state-run insurance³⁰ which is all right in principle, but is doomed to failure in reality. State-run enterprises are notoriously inefficient. This fact is apparent from the collapse of the socialist system and the rise of privatisation in most countries including Pakistan. That is why, perhaps, the CIIP in its 1992 recommendations showed flexibility regarding private insurance provided the *Shariah* compatibility of its operations is guaranteed. Given the disappointing performance of state enterprises, it would be better to encourage private *takafols* with necessary monitoring by the state.

From an operational viewpoint, the CIIP recommendations do not make any headway toward changing the character of *takafols* or enhancing their Islamicity. Therefore, some measures are proposed in the following section which, if adopted, shall improve the Islamicity of *takafols*.

V. RECOMMENDATIONS FOR ISLAMISATION OF TAKAFOLS

As discussed above, insurance is criticised due to *riba*, *gharar* and gambling. Judging *takafols* on the criteria of these prohibitions, it is clear that *riba* resulting from investment of insurance funds through interest-based channels is completely eliminated. There is an additional improvement as the *takafol* funds are employed into *halal* activities only while insurance investments are partly channelled into *haram* industries like casinos and liquor businesses.

Takafols, like insurance, contain *riba* because the contracts can still be interpreted as an unequal exchange of money. Besides, indeterminacy regarding instalments, and timings and accrual of indemnity and resemblance to gambling remain intact. In other words, elements of contractual *riba*, *gharar* and gambling still exist in *takafols*. Even the CIIP model is not absolved of these objections since its operational aspects are identical to the *takafol* operations. Few modifications are proposed here which, if incorporated, will enhance the Islamicity of the *takafol* operations.

Takafol and insurance provide cover for defined losses only to the participants in exchange of premium payments. The spirit of community cooperation

³⁰See CIIP (1984), *ibid*, p. 13.

is not imparted in the *takafol* contracts since indemnity is paid only up to defined monetary limits, which may or may not be sufficient to repair damages of the victims. Moreover, only the contributors to the *tabaru*, like the insured, are entitled to obtain indemnity and benefits out of the *tabaru*. If the *tabaru* is different from premium, then it shall also be accessible to other members in the community who cannot afford to buy *takafols*.³¹ Therefore, *takafols*, like insurance, are business deals devoid of community co-operation.

Contracts of *takafols*, like insurance, are prone to disputes among the insured and the insurers whenever a peril strikes. Disputes result because the hope of monetary gains supersedes the principles of honesty. Each party tries to shift the incidence of risks, even through legal battles, by finding faults with the other party. The onus of proving that the loss was caused by an insured peril rests upon the insured. The onus of proving that the loss was caused by an excepted peril rests upon the insurer. It is generally held that even an innocent misrepresentation of a material fact is no defence to the insured, if the insurer elects to avoid a contract.

The insured are required to disclose all material facts at the time of signing a contract. At the occurrence of an eventuality, the insurers could get the contracts void if it is found that certain facts were not disclosed even due to an innocent mistake or unintentionally. Insurers try to pay the minimum amount within the liability limit stipulated in money terms. Therefore, if the compensation required to cover intended loss rises due to inflation, then the insured is not fully indemnified.

In fact, following the prohibitions of *riba*, gambling and *gharar* would minimise business disputes and, thus, contribute to justice in the society. One may differ on the extent of these prohibitions in *takafols* and insurance, but, no one can deny that disputes are rampant. In fact, whenever a claim is filed, the insurers actively search for loopholes and excuses to avoid payment of compensation, while the insured actively manipulate and forge information in order to claim the maximum possible compensation. In addition, an insured may walk out of *takafol* contract after recovering indemnity, leaving others to bear the unpaid losses which makes the contracts inequitable. It is, therefore, desirable to modify the character of *takafols* to minimise disputes related with claims and compensations.

The aim of *takafol*, as well as insurance, is to combat loss on a self-supporting basis, although their approach is a bit different. It is proposed here that the mechanics of self-support shall be modified along the following lines.

³¹The CIIP has recommended that at least 10 percent of *takafol* fund be reserved for assistance to other deserving people. See CIIP (1992), *ibid*, p. 228.

First, the participants who incur claims, in excess of their contributions, shall be required to continue their usual payments until the excess received in indemnity is fully refunded to the *takafol*. The difference between the contributions and the compensations may be treated as *qard al-hasan* to the participants. If the insured dies before the payment of the *qard* then his heirs must bear the responsibility to clear it. The idea is that the participants should not have the incentive to shift the risk of loss to others although they can postpone unbearable losses. In fact, the adoption of the risk-bearing model would reduce exaggerations in claims by the participants as they cannot obtain material advantage on account of shifting burdens. The provision of *qard al-hasan* certainly represents the spirit of cooperation and also eliminates the possibility of gambling through *takafol*.

It is worthwhile to note that, in certain cases, participants may not have the ability to pay back the entire debt. Such participants may be given relief from the *tabaru* funds in a spirit of cooperation in consideration of his inability to pay the debt, but not as a right in exchange of premium payments. Such support can also be extended from the *zakah* fund. In other words, *zakah* funds of the company may be utilised to assist those participants who do not have the ability to bear losses. Similarly, assistance may be given to non-participating deserving individuals from the *tabaru* fund, rather than reserving it exclusively for the benefit of the contributors to the *tabaru* only.

Second, the indemnity shall be to the extent of the actual loss in property and not, as practised currently, in the form of money units to the extent of monetary limits stipulated in the contracts among the insured and the *takafol* companies. There are several ways by which an insured can be indemnified: by cash payment, repairs, replacement, and reinstatement. It is proposed here that, wherever possible, the indemnity be made in kind only—in the form of necessary goods and services to the extent of the loss up to the insured interest. Otherwise, the insured may remain deprived of appropriate indemnity, particularly, in the face of inflation. This condition will eliminate the possibility of contractual *riba* from *takafols* as this would mean exchange of money with commodities, rather than money with money. In addition, the participants would be certain to obtain replacement of their real losses so that the extent of *gharar*, compared with the current practices of *takafols*, will be lessened. Gambling cannot take place under the proposed amendments as individual participants would have to continue to bear all their losses.

In sum, under the present system, policyholders, in *takafol* and insurance, have the incentive to shift incidence of risks to others. The object of the above proposals is to remove that incentive by incorporating risk-bearing conditions and,

thus, to eliminate risk-shifting which causes disputes. Conditions of risk-bearing and indemnity in kind will change the character of existing *takafols* and free them from the odium of contractual *riba*, gambling and, to some extent, *gharar*.

Comments on
“Comparative Study of Insurance and *Takafol*
(Islamic Insurance)”

The author of the paper states that task of his “study is to review the issue of insurance and *Takafol* and make some recommendations for further improvement”. In this connection his objectives were to review the “Islamic debate on insurance”, to bring out the “operational features of *Takafols*”, to review the CIIP’s Islamic Insurance Model and to make some proposals to “improve Islamicity of *Takafol* contracts”.

In my view the author has miserably failed in achieving any of these objectives. The Islamic debate on insurance is well-documented in the literature especially the Council of Islamic Ideology, Government of Pakistan (CIIP), in its June, 1992 ‘*Report on Islamic Insurance System*’ has exhaustively discussed it and earlier studies by Mufti Muhammad Shafi, Dr Najatuallah Siddiqui, Muslehuddin etc. have already covered it in a satisfactory way. There is nothing in this paper, which adds to what is already available in the literature.

With regard to the operational features of *Takafols*, the CIIP has also done justice to this topic in its June 1992 report. Here too the author could not bring out any new features of *Takafols*, which have already not been covered by the Council.

As regards the review of the CIIP’s proposed model of Islamic Insurance, I feel that deep religious knowledge and background are needed to understand and appreciate the model. The model is presented in the CIIP’s ‘*Report on Islamic Insurance System*’ dated June 4, 1992. This report was prepared after consultations with the most prominent *ulema*, economists and insurance experts of the country. The report was the result of more than a decade’s efforts and deliberations made by the members of the CIIP. In my view, the model presented in the report is the best available and the most acceptable alternative for modern insurance from the Islamic point of view. Without properly giving an adequate outline of the CIIP proposed model and its salient features, the author has tried to criticise it. The author’s criticism is mainly related to such points as the CIIP’s recommendation regarding state-run insurance, because in his view “state-run enterprises are notoriously inefficient”. The fact of the matter is that the CIIP recommends that

the business of Islamic insurance be run by the public sector, so that government may take the responsibility of running this business according to all *Shariah* requirements and details as suggested by the Council. The Council has also pointed out in its report that if the above requirements can be guaranteed, Islamic insurance business can also be run by private and semi-government corporations.

Most of his suggestions regarding Islamisation of *Takafols* also do not help in improving the Islamicity of *Takafol* contracts. One of his suggestions in this regard is that “wherever possible the indemnity be made in kind only”, which in his opinion “will remove the element of *Riba* from *Takafols*, as this means exchange of money with commodities rather than money with money”. The fact of the matter is that *Riba* will remain *Riba* whether payment is made in money or in real goods. This reflects a misinterpretation on his part of the Islamic Principle of transactions involving *Saraf* (i.e. transaction of money with money, or gold with gold etc.). Most of his proposals do not help in removing elements of *Riba* (interest), gambling and *gharar* (uncertainty) from the insurance business, while the CIIP’s above-cited report has dealt with all these aspects in a very satisfactory manner.

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