Takaful and Retakaful

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Abstract: This book provided an introduction to takaful, its pitfalls, key contracts, and an overview of takaful in several Muslim countries. The book detailed the various takaful business structures and how they are governed under Shari'ah law. This book also examined the views of prominent Islamic finance regulators like the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and the Central Bank of Malaysia to provide definitive answers to contentious questions about Takaful. The effects of the Covid-19, or bird flu, pandemic on the takaful sector were also evaluated, and solutions were provided. This book discussed the environmental, economic, and social sustainability of takaful. Types of retakaful, Shari'ah considerations, and operational and model retakaful are discussed in this book. Finally, various solutions to the problems and difficulties of retakaful have been proposed.

Keywords: Takaful and retakaful, islamic finance, shariah governance, economic sustainability, financial regulation

TAKAFUL and RETAKAFUL

PRINCIPLES, PRACTICES and CHALLENGES

ISSA KHAN

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TAKAFUL and RETAKAFUL PRINCIPLES, PRACTICES AND CHALLENGES ISSA KHAN

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Issa Khan

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DEDICATION

I am highly blessed to dedicate this book to my beloved
Father: Idris Ali Khan
Late Mother: Anwara Begum & Present Mother: Shajeda Begum

-Issa Khan-

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PREFACE

بسم الله الرحمن الرحيم

By the name of Allah, the Most Gracious, the Most Merciful

In the name of Allah, the Most Gracious, the Most Merciful. All praise is for Allah, the Lord of every seen and unseen thing. Peace and prayers be upon Prophet Muhammad and his family and all his Companions and whoever follows his guidance.

Although several books have been written on takaful, re-takaful books are still very few. Therefore, it is needed to understand the operation of takaful and re-takaful and their modus operandi based on Sharīʿah principles. The book analyzed the opinions of contemporary Islamic scholars and the famous regulatory bodies for Islamic finance. i.e., Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and Central Bank of Malaysia also known as Bank Negara Malaysia (BNM). Therefore, it resolved many disputable issues related to Takaful that make the book compatible with the global markets. The book also focused on the impact of Covid-19, pandemic, on Takaful industry and proposed some solutions accordingly. This book addressed the sustainability of Takaful related to environment, economy and society. Finally, this book discussed about Re-takaful and its oparationnal methoud, shariah aspect and challenges. I hope that this book will assist not only professionals in takaful and re-takaful but everyone who will read it in general.

I would like to express my deepest gratitude to Abdul Muneem for his assistance and technical support that made this book possible.

I would like to thank my wife, Tania Lopin Khanum and my daughter, Juwairiyyah and my son, Abdullah Al-Faiz for their patience, support, and encouragement during the writing of the book.

Issa Khan

21 February 2023/29 Rajab, 1444 Hijri

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INTRODUCTION

Allah says in His Holy al-Quran:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

(al-Qur'an, 02:175)

Allah has permitted trading and forbidden riba (usury).

As human beings, Muslims involve in financial transactions in their daily lives. They should, therefore, follow Allah's order in their financial transactions with others. This book discuss the theory, principles, and practices of Takaful (Islamic insurance) which are proposed by Shariah scholars specialized in *fiqh al-mu'amalat* (financial transactions) and particularly related to Takaful. It is known that the circle of life is developing very fast and, as a result, many changes take place in the human lifestyle. All these changes are consequences of development in international relations and, especially, because of commercial and financial development. Certainly, the topic of Takaful is one of those recent emerging issues. The total Takaful assets in 2021 in at global context is US$73 billion. So, it shows that there are increasing of about 17% in annual growth. Before Covid-19, the Takaful assets growth shows an increase from the year 2012 to 2016. But there was a decrease from the year 2016 to 2018. However, in the year 2019, it shows an increase again which is from US$46 to US$51 billion. It increased more when Covid-19 hit the world at the end of 2019 and early 2020. In 2021, the takaful assets have a growth of US$73 billion. This is probably due to the awareness and acknowledgment from people of the importance of having takaful since the Covid-19 pandemic. Figure 01 shows the Takaful assets growth from 2012 until 2021 in a global context.

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CHAPTER 1
INTRODUCTION TO TAKAFUL

In this chapter, the author discusses the basic concept of takaful including definition, legitimacy, and types of takaful. The author also focuses on types of insurance based on different perspectives. This study also seeks to explain *riba* (usury), *gharar* (deceiving) and *maisir* (gambling) and how they are used in conventional insurance. At the end of this chapter, the elements of the takaful system will be discussed as well.

Concept of Takaful (Islamic Insurance)

Prophet Muhammad (PBUH) said:

> أنس بن مالك يَقُولُ قَالَ رَجُلٌ يَا رَسُولَ اللَّهِ أَعْقِلُهَا وَأَتَوَكَّلُ أَوْ أُطْلِقُهَا وَأَتَوَكَّلُ قَالَ اعْقِلْهَا وَتَوَكَّلْ

> *Anas Ibn Malik narrated that a man said: "O Messenger of Allah! Shall I tie it (Camel) and rely (upon Allah), or leave it loose and rely (upon Allah)?" He said: "Tie it and rely (upon Allah)" (Al-Tirmidhi, 1996)*

This is a conversation that took place between the Prophet (PBUH) and one of his companions which reflects on the reduction of the risk of loss by believers. Further, this is also a response to some people who might misunderstand the teachings of Islam and think that Islam does not allow risk mitigation and that believers must rely on what Allah has written for their future (Jaffer et al., 2010; Billah, 2019).

Before 570CE, the ancient Arab tribes used to practice the concept of *al-'aqilah* (blood-money). The Arab tribes were using this concept to compensate for the loss of a family during that time, and this was like if a person from a tribe is killed by another tribe, the close relatives of the killer will take responsibility of paying compensation to the victim's tribe for their loss. In another word, it can be explained that the concept of *al-'aqilah* was to collect money from the close relatives of the killer in order to pay compensation to the victim's family which is a cooperation among the killer's family to fulfill the duty of *al-'aqilah* on their time. The practice of *al-'aqilah* can be related to the concept of contemporary takaful or Islamic insurance as takaful is based on the cooperation among

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CHAPTER 2
OVERVIEW OF TAKAFUL - SOME MUSLIM COUNTRIES

First Takaful company started its operation in 1979 in Sudan and then spread in deferent parts of the world. This chapter will demonstrate the situations of applying takaful in several Muslim countries. The development of Takaful and the impact of Covid-19 on the Takaful industry will be addressed in order to show the most severe impact on the takaful industry encountered in this period.

Overview of Takaful in Several Muslim Countries

Takaful in the Kingdom of Saudi Arabia

The Arab Islamic Insurance Company is the first takaful company established in the Kingdom of Saudi Arabia in the year 1979 (Hussain and Noor, 2018). This came after the issuance of a fatwa approving the concept of cooperative insurance by the Permanent Committee for Scholarly Research and *Ifta* of the Council of Senior Scholars in the Kingdom, which affected both Islamic and traditional insurance in the country. This was accompanied by the issuance of a royal decree authorizing the establishment of the National Company for Cooperative Insurance in the year 1984 governing the spread of cooperative insurance and related matters in the country. The authorized capital of this company was USD 133 million, and the paid-up capital was USD 66 million (Bekkin, 2007). Insurance companies operate in Saudi Arabia, according to the Cooperative Insurance Law of 2003. It is worth noting that the insurance market in Saudi Arabia is distinguished from other markets in the world as it is an Islamic market only as insurance companies were obligated to operate according to the cooperative model. However, the method of this cooperation is not mentioned (Alshammari et al., 2022). But the separation of the participants' funds from the company's fund has been mentioned clearly.

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CHAPTER 3
SHARĪʿAH CONTRACTS, MODELS, PRODUCTS AND SHARĪʿAH GOVERNANCE OF TAKAFUL

The takaful system has to adopt Islamic financial contracts in order to provide services. Several contracts have been introduced by modern Islamic scholars. There is a dire need for those contracts to be used in the contemporary financial systems. Some of the important contracts like *Tabarru* (donation), *wa'd* (promise), *waqf* (endowment), *wakalah* (agency), *mudarabah* (profit-sharing contract), their rules and method of practicing them in takaful are explained below:

Tabarru (donation)

The concept of *Tabarru* is one of the contracts that the takaful system operates with. The word *Tabarru* basically means to donate or to give something as a gift. In the practice of the takaful system, the term *Tabarru* is used for collecting a contribution from the participants and they agree to pay a certain amount in instalments (premium) in order to fulfill their obligation towards mutual assistance among the participants whenever someone encounters any trouble (Yusof, 1996). According to classical

Fiqh scolars, Tabarru in Shariah is legitimate (Al- 'Uthmani, 2003, 42). In other words, the concept shapes the participants to be cooperative and to help each other in the event of any unexpected incidents in order to ensure brotherhood among the society members (Hachemi et al., 2014).

The practice of using *Tabarru* in Shariah is permissible and it is well appreciated in many verses and hadiths. The common and famous verse in this regard is: "Help you one another in *al-birr* (righteousness) and *al-taqwa* (piety)" (al-Qur'an, 05:02). The verse emphasizes the cooperation among the believers for a good cause while it prohibits doing it so in sinful acts. The verse also shows that not helping in sinful acts will protect

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CHAPTER 4
THE PHILOSOPHICAL ASPECTS OF TAKAFUL

The takaful industry must follow the basic principles of Shariah regarding the financial matters in providing takaful services. In addition, the industry also needs to adopt the standards and guidelines set by scholars. Since the purpose of takaful is the cooperation, and assistance among the participants, it can be said the cooperative insurance and Takaful are having the same spirit. And, based on that cooperative insurance is also called takaful (Abu Zaid, 2011). However, those principles and standards differentiate between conventional insurance and takaful and thereby differentiate the Islamic transaction from the non-Islamic transaction. The important principles and guidelines of Takaful are discussed below:

The Cooperation

Takaful relies on the cooperation, assistance, and solidarity among the participant of the takaful. Takaful is based on the people's cooperation and donation, and it's not based on their mu'awadah (exchanging contract) (AAOIFI, 2015). Thus, cooperation is the main purpose of takaful and also the elimination of harms from them. Therefore, the majority of the contemporary scholars agreed that based on cooperation and exchange, a takaful system will be permissible in Shariah (Qureshi, 2011). On the other hand, conventional insurance intends to make a profit only over the insurance operations instead of considering the cooperation among the subscribers (AAOIFI, 2015). The author also corroborates with the majority of scholars on the permissibility/legitimacy of takaful as it complies with the evidence from Qur'an and Sunnah. It is stated in the holy al-Qur'an:

وَتَعَاوَنُوا عَلَى الْبِرِّ وَالتَّقْوَى

(al-Qur'an, 05:02)

Help you one another in al-birr (righteousness) and al-taqwā (piety).

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CHAPTER 5
ISSUES, CHALLENGES AND SUSTAINABILITY OF TAKAFUL

Although Takaful industry has risen around the world, it is still confronting many issues and challenges in its operations and services. However, in order to sustain the takaful industry many initiatives can be taken. This chapter will discuss the important issues, challenges, and sustainability of Takaful.

Issues and Challenges of Takaful in Different Jurisdictions

The practice of takaful in different jurisdictions has its own way of applying the models to provide such services to the people. There are some countries that have their own legal acts by the government such as Malaysia whereas some other countries do not have any legal acts, but they are still allowed to provide takaful products following the insurance act or any other legal provisions that allow such services. Moreover, the diversity in takaful from an operational perspective in different jurisdictions shows the flexibility and compatibility of the practice. However, the takaful industry is still facing many issues and challenges on their application and services around the world. The important issues and challenges are discussed below:

Surplus Distribution

The takaful operating system in Malaysia varies from the takaful system in GCC and other regions in a few matters. One of the most salient points is the distribution of surplus among the participants and takaful operators. The surplus is the remaining fund of all contributions and investments, after paying all the claims, compensation, and other liabilities (Al-Jurf, 2004). AAOIFI (2015, 699) defines surplus as: "The Surplus comprises of residual premiums of the participants (the insured) in addition to the reserves and profits, after deducting all expenses and indemnity amounts (paid or payable during the same year). The residual amount, thus computed, is considered as surplus, rather than profit".

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CHAPTER 6
INTRODUCTION TO RE-TAKAFUL

This chapter discusses the basic concept of re-takaful, its definition, types, role, Shari'ah, and operational aspects. It further focuses on methods and models of re-takaful.

Concept of Re-takaful

Every human activity is subject to the risk of loss due to unpredicted events. Fortunately, there are several ways to alleviate the consequences of risks, and one of the methods is through insurance. To mitigate the financial burden of the Muslim communities caused by risks, takaful is introduced (Ahmad et al., 2016). Conventional insurance also ensures risk to transfer it another party (G. Blazenko, 1986). Reinsurance is prohibited from the Islamic perspective. Thus, Re-takaful is introduced to protect the Takaful operators by sharing risks (NuHtay et al, 2014). Re-takaful is commonly known as Islamic reinsurance, as it is carried out in accordance with Islamic principles. According to Rosmi Yuhasni Mohamed Yusuf (2011), the concepts of Re-takaful are the same as Takaful, aside from the participants involved directly in the Takaful operators where the Takaful operators deal with the Re-takaful company.

Re-takaful is "a contract of donation (*uqud al-tabarruat*)" that applies the same Shariah practices and principles as Takaful. According to NuHtay et al. (2014), the risks and liabilities of respective Takaful operators will be shared under a Re-takaful scheme according to specific re-takaful contributions into a specific re-takaful Risk Fund over a certain period. A Re-takaful operator will be in charge of the re-takaful scheme based on a variety of contracts, including *al-wakalah*, *al-mudharabah*, or hybrid models. All aspects of the Re-takaful operator's business, including its underwriting, investment, financing, and claims processes, as well as its retrotakaful practice, have to be managed in line with Shari'ah practices and principles.

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CHAPTER 7
ISSUES, CHALLENGES AND SUSTAINABILITY OF RE-TAKAFUL

Since the re-takaful operation is still relatively new to the Takaful sector, it is imminent that is dealing with a variety of problems and difficulties in the age of globalization in addition to the requirement to adhere to Shariah principles (Ismail et.al, 2021). The important issues and challenges that the re-takaful industry, practitioners, and other concerned parties face and suggestions for the improvement of re-takaful are all addressed in this chapter. This chapter further highlights the sustainability of re-takaful.

Issues, and Challenges of Re-Takaful

Re-takaful operators

The cost and effectiveness of re-takaful as a leveraging mechanism are a source of worry. According to Cummins, et al. (2021), the cost of reinsurance generally which also applies to re-takaful, is not proportionate to the genuine risk ceded. It sometimes costs more than the actuarial value of the risks covered. According to a report by the Organization for Economic Cooperation and Development (2018), reinsurance businesses received more premiums from insurance companies between the years of 2014 and 2016 than they did claims payments. The industry's average re-takaful outlay was roughly 25% of takaful contributions as opposed to the conventional insurance sector's average outlay of 19%. This is why the sector has been asked to keep reinsurance and takaful costs to 15% to 20% of total takaful contributions and premiums. In order to enhance the country's balance of payments policy, this will also serve to "contain" the needless re-takaful/reinsurance contributions/premiums outflow, particularly to the foreign reinsurance market.

The takaful operator

The Takaful operator in the market has a selection of models to choose from. The huge range of behaviors and model choices among nations is a

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This book provided an introduction to takaful, its pitfalls, key contracts, and an overview of takaful in several Muslim countries. The book detailed the various takaful business structures and how they are governed under Shari'ah law. This book also examined the views of prominent Islamic finance regulators like the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) and the Central Bank of Malaysia to provide definitive answers to contentious questions about Takaful. The effects of the Covid-19, or bird flu, pandemic on the takaful sector were also evaluated, and solutions were provided. This book discussed the environmental, economic, and social sustainability of takaful. Types of retakaful, Shari'ah considerations, and operational and model retakaful are discussed in this book. Finally, various solutions to the problems and difficulties of retakaful have been proposed.

About author

DR. ISSA KHAN currently serves as a senior lecturer at the Department of Shari'ah and Management, Academy of Islamic Studies, **University of Malaya (UM).** He achieved his Doctoral Degree (PhD) in 2015 in Islamic insurance and a master's degree in 2011 in fiqh al-Muamalat (Islamic Law of Transactions) from the University of Malaya, Malaysia. During his master's degree, he was awarded University of Malaya Fellowship Scheme and during his PhD degree, he was honored also the Bright Sparks Scholarship from the same university. Prior to his master's degree, he completed his bachelor's degree (B. A. Hons) in Islamic Studies & Da'wah from Darul Ihsan University, Bangladesh in 2006. He also completed his Takmil degree (Dawrah Hadith) in Hadith from Jamiyah Arabiyah Makhzanul Ulum, Mymensingh, Bangladesh in 2001. Dr. Issa has several publications in national and international academic highly indexed journals. He has been appointed as a reviewer of several journals and is reviewing many academic papers throughout the years. His research interest includes takaful, Islamic management, Islamic banking, Islamic finance and Shariah studies.

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