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Business Operation Model with Sharia Concerns and Proposed Resolution for Takaful

[1]Mohd Shahril Ahmad Razimi, [2]Abd Rahim Romle and [3]Aziemah Ahmad

[1,3]Islamic Business School, Universiti Utara Malaysia, 06010 Sintok, Kedah, Malaysia
[2]School of Government, Universiti Utara Malaysia, 06010 Sintok, Kedah, Malaysia

Abstract: Islamic insurance or known as Takaful has been widely used in the world especially Islamic countries because of the awareness of implementing shariah principles in their business transactions. Takaful operators have implemented a few types of Takaful business operation model which believed to be based on shariah principles. However, there are some issues regarding the permissibility of the models by shariah scholars. Hence, this paper aims to analyse the basic principles of Takaful and eventually an analysis of available Takaful models that being used in the industry. In addition, a proposed model will be discussed as the resolution of all of the models available.

Key words: Takaful · Insurance · Islamic · Shariah · Tax

INTRODUCTION

Takaful which is known as Islamic insurance refers to Arabic root word of kafala that means guaranteeing each other [1]. Takaful differ from conventional insurance because it is grounded to Islamic law or known as shariah. Therefore, Takaful is free from the elements of maisir, riba and gharar which are prohibited by shariah. It operates on pooling system where participants contribute their money in order to mutual guarantee among themselves from any losses or damages. The takaful system is based on principle "Tabarru" which refers to donation or charity [2]. It is considered as a tool for risk management and distribution according to mutual assistance and solidarity or known as ta'awun in Arabic. Moreover, individual risks are not transferred to a third party – par adventure an insurance company – as is the case with conventional insurance [3] but it is based on mutual sharing among participants in protection from losses incurred. At the end of each financial year, if the fund has not been exhausted by the payment of claims, any excess is distributed among the members to the ratio of their contributions [4].

In the meantime, Takaful industry has made a rapid growth since it is started in Sudan in 1979 and expanded to Saudi Arabia and now over 22 countries has adopted the concept of Takaful. With that, Takaful has been recognized as conventional insurance alternatives which is clearly prohibited by the shariah practices. In fact, Takaful market which consist of life, family and general takaful products have received over U.S$2.1 billion of contributions and increased to U.S$12.5 billion by 2015. It indicates that business expectations maybe materializing at a fast growth, driven to a large extent by strong market growth in the Gulf region and especially Malaysia [5]. In Malaysia, the first Malaysian Takaful Company was recognized in 1985 and it was established under Takaful Act 1984 [6]. Hence, it can be concluded that local Takaful industry has been around over 30 years.

Corresponding Author: Mohd Shahril Ahmad Razimi, Islamic Business School, Universiti Utara Malaysia.
E-mail: shahril@uum.edu.my.

Since then, Takaful operators has been introduced with numerous Takaful models so that the operations are running accordingly to shariah principles. There are six types of Takaful Models which are namely as al-Mudharabah, Musyarakah, Wadi'ah Yad Dhamanah, al-Wakalah, Waqf and Ju'alah [7, 8]. Nonetheless, al-Wakalah and al-Mudharabah types of Takaful Models that are merely applied by Malaysian Takaful operator [7, 8, 9]. With that, the objective of this study is to analyse the Takaful Models available with shariah concerns and to propose the most suitable Takaful Model for Malaysian Takaful operators.

Background of Study: As stated in shariah, there are three elements which are prohibited in Takaful operations. Firstly, element of gharar is prohibited in conducting Takaful business. It refers to any liabilities that uncertain, undetermined or contingent [10]. Therefore, any exchanges or contracts that involve gharar element is forbidden. In making a contract valid according to Islamic law, mutual consent between two parties is the basic requirement. It is crucial in order to avoid misinterpretation of information due to insufficient information given. This is pertaining to conventional insurance where element of gharar arises when the amount of indemnity to be paid during time of loss occurrence is uncertain. Moreover, uncertainty of loss represents risk which lead to nature of gharar. So, that kind of nature in a contract is existed in conventional insurance which make it forbidden in Takaful operations. However, most scholar start to recognize that actuarial practices entails social benefits and non-excessive gharar is allowed or contractual uncertainty, not to uncertain outcomes [11].

Apart from that, element of maisir is also prohibited in operating a Takaful business. It derives from Arabic word which means getting something easily or making profit without working for it. Hence, it is associated with any activities of making speculations and also gambling. The element of maisir is detected in conventional insurance since the policyholders are considered gambling on their premiums by expecting to get indemnity in the time of loss occurred. In the meantime, insurance company is also regarded as taking profit without working on it due to fortune of the policyholders.

Lastly, element of riba is one of the forbidden elements in conducting Takaful business. Riba is derived from Arabic word that means interest. Prohibition of riba is align with Muslim scholars who recognized it as unlawful due to unfavourable impact to social and economy of ummah or society. It clearly shows that this element is contradict with the spirit of brotherhood which is widely practiced by Muslims. In addition, element of riba arises in conventional insurance since the amount of premium paid by policyholders are differ. Meanwhile, involvement in interest-based investment is also part of riba practices. At the same time, investment on any other haram activities or items such as pork, alcohol or gambling are also the elements that are forbidden in Islam.

As a result, a set of allowable Takaful Models should be practiced by Takaful operators. The models should be free from any forbidden elements due to shariah concern. In the meantime, the models also need to be practical to be adopted so that it aligns with the Takaful business objectives. Therefore, four types of Takaful Model will be analysed in this study in order to determine the best resolution for Takaful operators.

Literature Review

Mudharabah Model: In Takaful, Mudharabah model is a profit sharing contract [12] where participants are the provider of capital namely as contribution and Takaful operators are entrepreneur who manage the fund. Hence, Takaful operators share a certain portion of profits with the participants and expenses management is their responsibility. This model is being used in two types of Takaful plans which are family Takaful plan and general Takaful plan. They are difference in term of participants' contributions.

Family Takaful plan divides participants' contribution into two separate accounts. First account is namely as Participants' Account (PA) where most of the participants' contributions taken place. Meanwhile, another account is Participants' Special Account (PSA) where will be used to pay claims including cost of underwriting. Both of the accounts are used to invest in Halal investments' instruments. Then, the profit from the investment will be shared based on the profit ratio agreed by Takaful operators and the participants. Besides that, Takaful operators are eligible to claim on any underwriting surplus as an incentive for managing the Takaful funds contributions.

On the other hand, general Takaful plan does not involve Participants' Account (PA) so all of participants' contribution is included in Participants' Special Account (PSA). It will be used as an investment and also claim payment includes cost of underwriting. In the meantime, the profit from investment and underwriting surplus is regarded as contingency fund to the Takaful operators. If there is any excess amount, the profit will be shared among Takaful operators and participants based on agreed proportion. The Mudharabah Model can be shown in Diagram 1.

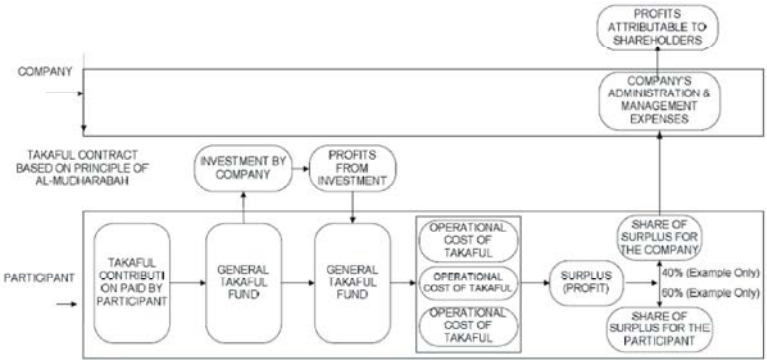

Diagram 1: Mudharabah Model
Source: Wahab [13]

Wakalah Model: In Wakalah Model, it refers to a fee based in a contract where a party provides capital whereby another party acts as a manager of the capital or funds. Unlike Mudharabah Model which emphasize on profit sharing basis, Wakalah Model imposed a fee charges that is fixed. In Takaful contract, participants provide capital in the form of contribution and Takaful operator manages the funds and charges a fixed fee (called a Wakalah fee) for providing its services [14]. The fixed charges are determined fairly and appropriately by Shariah Supervisory Board who is also give approvals. This type of model is considered more transparent since all the charges are stated clearly. Moreover, Takaful operators also imposed additional fee on any surplus that regarded as incentive for managing the fund of participants' contributions. Therefore, issue of hidden charges can be avoided by implementing this model in Takaful business.

In addition, the investment or savings portions will be credited to the PA account and the donation will be credited into the PSA [7, 15, 8, 6, 9]. The Wakalah fee is charged upfront (usually in the range of 20%-35% of the contributions) and will be transferred to shareholders' account. Meanwhile, the remaining contributions are transferred to participants' account in order to pay any claims made in the time of loss occurrence and cost of underwriting and others. The Wakalah Model can be shown in Diagram 2 below.

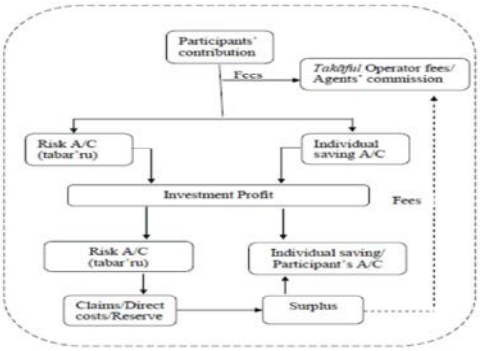

Diagram 2: Wakalah Model
Source: Wahab [13]

Hybrid Model: Hybrid Model refers to a combination of two types of Takaful Model which are Wakalah and Mudharabah Model. In this model, Wakalah fee is imposed on the contribution whereas Mudharabah on the investments [7, 8, 9]. There are some Takaful operators made some modification on Mudharabah Model by sharing the surplus derived from underwriting [9]. It is proven that PSA is not only channelled to the participants but it is also distributed to the Takaful operators at the same timd [16]. Hence, any surplus from underwriting will be returned to the participants. Diagram 3 shows how Hybrid Model works in Takaful business operations.

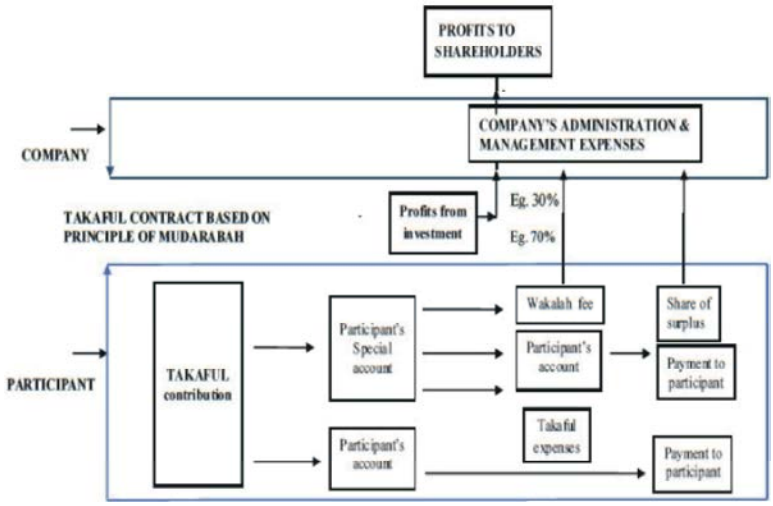

Diagram 3: Hybrid Model
Source: https://www.islamicbanker.com/education/takaful-%E2%80%93-hybrid-model

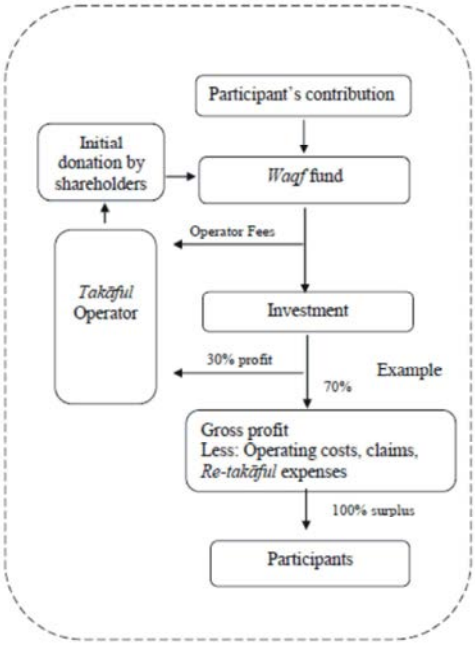

Diagram 4: Wakalah with Waqf Model
Source: Wahab [13]

Wakalah with Waqf Model: Waqf is derived from Arabic word that means donation and it has ability of accepting ownership or making anybody as the owner of any assets. The main objective of waqf is to offer a relieve to participants against any losses incurred. Waqf funds comes from different forms such as interest-free loans or money given for social benefits. However, the fund can be managed on commercial basis with fee imposed by the manager of the funds. In the case of Takaful, waqf is considered as part of tabarru or hibah (gift, donation). Nonetheless, in Wakalah contract, it is conditional to use the waqf fund to make claim payment when a loss occurred. Moreover, any surplus will be given back to the participants according to the agreed ratio in the event where the fund of claims is not fully utilized. The process of Wakalah with Waqf Model can be shown in Diagram 4 below.

From these four types of Takaful Models, a further discussion will be made on every single models in shariah context. With that, the most suitable model for Takaful business operation model can be recommended.

DISCUSSION & RECOMMENDATION

Mudharabah Model: The main objective of Takaful is for Takaful operator to pay a claim on any losses from the contributions from participants. Contributions is regarded as tabarru which emphasize on action of donation where there is no expectation of return. However, a few issues raised due to fund utilization on the time of loss occurrence. An issue on concept of tabarru is contradict of participant action in expecting return from the contributions made in prior of takaful contract. Meanwhile, most of takaful operators are considered as the custodians or treasurers and in other words, they are the owners of the fund [12]. Apart from that, an issue raised regarding association of tabarru (donation) with mudharabah (profit sharing contract). With that, this issue becomes as the main concern by Shariah scholars because a profit sharing contract should not be practiced due to the same occurrence of donation and mudharabah capital [17]. Besides that, underwriting surplus of sharing is making Takaful is just a flip of another coin of conventional insurance. It has made the shareholders bear the risk and return which is contradict with the concept of mutual assistance. This type of risk sharing seems to be irrelevant with Mudharabah model, wakalah model is implemented by takaful operators as their alternative of business operations.

Wakalah Model: Under wakalah model, the concept of tabarru has become as a conditional gift where a fixed fee charge is imposed to the participants' contributions unless the fund is fully consumed. Some issues like inheritance is raised due to impossibility of share of surplus measurement at time of death and also zakat in case of a person's death because the donation is considered as conditional gift. On the same time, the relationship between the participant and the Takaful operator including among participants themselves has become doubtful in shariah concern.

This situation has made Takaful contract is becoming a contract of compensation similar to conventional insurance practices. Apart from that, there are some issues on perceptive of generational. For instance, total amount of contingency funds might not justifiable from one generation to another generation since takaful operators tend to hold huge proportion in early contributions for future's sake. Hence, some participants need to contribute more than others in the case of deficit. However, it seems to be impractical to be implemented by Takaful operators and need to be further analysed. Another model namely as Wakalah with Waqf model is introduced in order to enhance the available models in Takaful business operations.

Wakalah with Waqf Model: In this model, Waqf fund has a direct relationship with participants and Takaful operator. Takaful operator acts as the agent or wakil of the waqf fund whereas the participant is the one who pays the donation in order to enter the Takaful contract. This type of model is believed to avoid uncertainty or gharar element in term of compensation. Besides being an agent or wakil of the waqf fund, Takaful operator is also act as an entrepreneur who manage the waqf fund by entering into any Halal investment. Moreover, Waqf fund consist of donations from participants and profit earnings from investment made.

However, participants are also eligible to utilize the waqf fund when they meet with any losses. Therefore, the ownership of waqf fund is transferred from participants to Takaful operator who manage the fund. A few questions regarding legal status are raised in implementation of this model. The legal status becomes ambiguous between trust act or any other acts because of the condition of fund itself. The tax implications on treating Waqf fund is also questionable. Hence, a further evaluation on this matter should be considered.

With some alternative framework, Takaful Model can be modified according to shariah concerns. Any issues raised in the implementation should be considered so that takaful industry will be grow further. The model framework should also be practical which align to the establishment of Takaful and will be beneficial to the ummah as a whole.

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