



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

INSURANCE DIVISION

Investor Education Guide Series © 2010

TAKAFUL

THE ISLAMIC INSURANCE

How it works for you?

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DISCLAIMER

This is a general guide book developed by the Securities and Exchange Commission of Pakistan, mainly focusing on the Takaful (Islamic insurance) and its most common products available in the market. Nothing in this guide book is intended to be, or should be construed as an invitation, offer or inducement to any person to enter into an insurance contract or an advice on the merits of or a recommendation in relation to, any particular product or service provider.

The purpose of this guide book on the topic of Takaful is to help policyholders understand the subject. The guide book complements the SECP's efforts for investor education and financial literacy.

This guide book is not intended as a comprehensive reference work on the subject of Takaful. Nor is it a substitute for the individualized advice that may be provided by qualified business and legal professionals. Rather, we intend it to be a concise and practical description of essential Takaful components together with suggested approaches to understanding the products. Further details on the topics covered by this guide book can be found in the extensive literature that exists on this subject.

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1. INTRODUCTION

Islamic finance has developed mainly in two directions namely Islamic banking and Islamic insurance (Takaful). While information about Islamic banking is being increasingly disseminated, features, models and structures of Takaful are little known particularly in Pakistan. Purpose of this brief guide book is to describe main features and models of Takaful system operating in various parts of the world in general and Pakistan in particular.

All human beings are invariably exposed to the possibility of meeting catastrophes and disasters giving rise to misfortunes and sufferings such as death, loss of limbs, accident, destruction of business or wealth, etc. Notwithstanding the belief of all Muslims in Qadha-o-Qadr, Islam provides that one must find ways and means to avoid such catastrophes and disasters wherever possible, and to minimize his or his family's financial losses should such events occur. One possible way out is to buy an insurance cover as in the conventional system. Different views have been expressed about the status of conventional insurance from the point of view of Islam. An overwhelming majority of the Shariah scholars believe that it is unlawful due to involvement of Riba (interest), Maisir (gambling) and Gharar (uncertainty).

2. DEFINITION OF TAKAFUL

Takaful (التكافل) is an Islamic insurance concept which is grounded in Islamic *muamalat* (banking transactions), observing the rules and regulations of Islamic law. Takaful is basically a system of Islamic insurance based on the principle of *Ta'awun* (mutual assistance) and *Tabarru* (voluntary contribution), where the risk is shared collectively by the group. It is operated on the basis of shared responsibility, brotherhood, solidarity and mutual cooperation or assistance, which provides for mutual financial security and assistance to safeguard participants against a defined risk.

The word Takaful is derived from the Arabic verb *Kafala*, which means to guarantee; to help; to take care of one's needs. This concept has been practised in various forms for over 1400 years. Muslim jurists acknowledge that the basis of shared responsibility in the system of aquila as practised between Muslims of Mecca and Medina laid the foundation of mutual insurance. It is based on the concept of social solidarity, cooperation and mutual indemnification of losses of members. It is a pact among a group of persons who agree to jointly indemnify the loss or damage that may inflict upon any of them, out of the fund they donate collectively.

The Takaful contract so agreed usually involves the concepts of *Mudarabah*, *Tabarru* (to donate for benefit of others) and mutual sharing of losses with the overall objective of eliminating the element of uncertainty.

3. ISLAMIC REFERENCES TO TAKAFUL

These fundamentals are based on the sayings of the Islamic Prophet Muhammad (PBUH). Based on the *hadith* and Quranic verses mentioned below, Islamic scholars had decided that there should be a concerted effort to implement the Takaful concept as the best way to resolve these needs. Some of the examples are:

- **Basis of Co-operation** Help one another in *al-Birr* and in *al-Taqla* (virtue, righteousness and piety): but do not help one another in sin and transgression. (*Surah Al-Maidah, Verse 2*). Allah will always help His servant for as long as he helps others. (*Narrated by Imam Ahmad bin Hanbal and Imam Abu Daud*)
- **Basis of Responsibility** The place of relationships and feelings of people with faith, between each other, is just like the body; when one of its parts is afflicted with pain, then the rest of the body will be affected. (*Narrated by Imam al-Bukhari and Imam Muslim*) One true Muslim (*Mu'min*) and another true Muslim (*Mu'min*) is just like a building whereby every part in it strengthens the other part. (*Narrated by Imam al-Bukhari and Imam Muslim*)
- **Basis of Mutual Protection** By my life, which is in Allah's Power, nobody will enter Paradise if he does not protect his neighbour who is in distress. (*Narrated by Imam Ahmad bin Hanbal*) The basic fundamentals underlying the Takaful concept are very similar to cooperative and mutual principles, to the extent that the cooperative and mutual model is one that is accepted under Islamic Law.

4. PRINCIPLES OF TAKAFUL

The principles of Takaful are as follows:

- Policyholders cooperate among themselves for their common good.
- Every policyholder pays his subscription to help those that need assistance.
- Losses are divided and liabilities spread according to the community pooling system.
- Uncertainty is eliminated in respect of subscription and compensation.
- It does not derive advantage at the cost of others.

Theoretically, Takaful is perceived as cooperative or mutual insurance, where members contribute a certain sum of money to a common pool. The purpose of this system is not profits but to uphold the principle of "*bear ye one another's burden*". Commercial insurance is not allowed for Muslims as agreed upon by most contemporary scholars because it contains the following elements:

1. *Al-Gharar* (Uncertainty)
2. *Al-Maisir* (Gambling)
3. *Riba* (Interest)

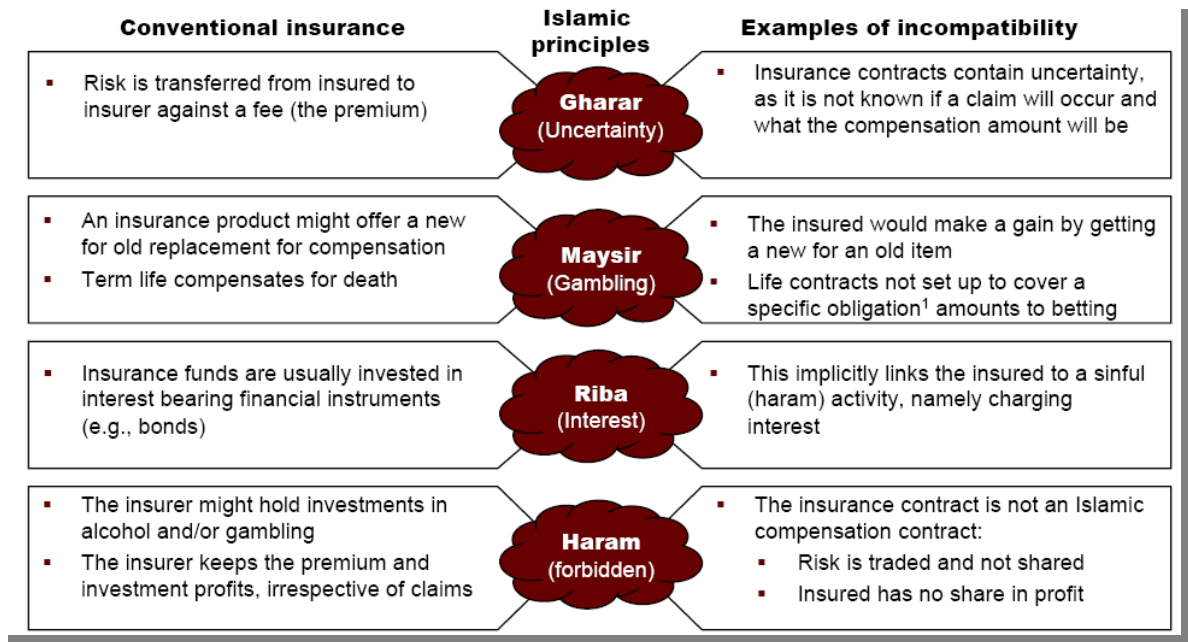


Illustration of Al-Gharar, Al-Maisir and Riba

Before we proceed further, we need to understand these three concepts:

4.1 *Al-Gharar* (Uncertainty)

The Arabic root for *gharar* means deception - but in practice the term is used quite widely. *Gharar* encompasses: uncertainty, risk, hazard and deceit. The origin of *gharar* can be divided into two categories, namely: *tadlis* (cheating in business) and *ghabn* (to deceive). All businesses involves some level of risk, therefore unlike *riba*, *gharar* is a relative concept when it comes to uncertainty, risk and hazard - with a certain level of uncertainty being tolerated. However, when it comes to deceit or fraud, *gharar* is an absolute concept.

4.2 *Al-Maisir* (Gambling)

Maisir means a game of haphazard in all matters-particularly a game of chance by means of divinatory arrows. *Maisir* is of various categories. Some of these types of *Maisir* are seeking omen or fortune by divinatory arrows, back-gammous, chess, lottery etc. Gambling is of two categories : a game of chance that is partaken in with a view of sports (fun) and the game of chance which involves gambling. Gambling means all dealings in which people are

required to make a bet and every dealing which involves some aspect of gambling is *Maisir*.

4.3 Riba (Interest)

In the conventional literature, interest is seen as the time value of money, however, money in Islam is seen simply as a medium of exchange - with no intrinsic value in itself - so it is impermissible to lend money and earn a guaranteed rate (interest) on the money. The Arabic word *riba* literally means "an addition to" or "excess" over the original price of the good or service.

5. MODELS OF TAKAFUL

There are two models and several variations on how takaful can be implemented.

5.1 Mudharabah Model

Under the pure *mudharabah* model, the takaful operator and the participant share direct investment income only and the participant is entitled to a hundred percent share of the surplus. However, under the modified mudharabah model, the investment income is ploughed back into the takaful fund and the takaful company share with the participant the surplus from the takaful fund.

By this principle, the entrepreneur or *al-Mudharib* (takaful operator) will accept payment of the takaful installments or takaful contributions (premium) termed as *Ra's-ul-Mal* from investors or providers of capital or fund (takaful participants) acting as *Sahib-ul-Mal*. The contract specifies how the profit (surplus) from the operations of takaful managed by the takaful operator is to be shared, in accordance with the principle of *al-Mudharabah*, between the participants as the providers of capital and the takaful operator as the entrepreneur. The sharing of such profit may be in a ratio of 50:50, 60:40, 70:30, etc. as mutually agreed between the contracting parties.

In order to eliminate the element of uncertainty in the takaful contract, the concept of *tabarru* (to donate, to contribute, to give away) is incorporated. In relation to this concept, a participant shall agree to relinquish as *tabarru*, certain proportion of his takaful installments or takaful contributions that he agrees or undertakes to pay should any of his fellow participants suffer a defined loss. This agreement enables him to fulfill his obligation of mutual help and joint guarantee.

In essence, *tabarru* would enable the participants to perform their deeds in sincerely assisting fellow participants who might suffer a loss or damage due to a catastrophe or disaster. The sharing of profit or surplus that may emerge

from the operations of takaful, is made only after the obligation of assisting the fellow participants has been fulfilled. It is imperative, therefore, for a takaful operator to maintain adequate assets of the defined funds under its care whilst simultaneously striving prudently to ensure the funds are sufficiently protected against undue over-exposure. Therefore the provision of insurance cover as a form of business in conformity with Shariah is based on the Islamic principles of *al-Takaful* and *al-Mudharabah*.

Al-Hari Raya is the pact among a group of people, called participants, reciprocally guaranteeing each other; while *Al-Mudharabah* is the commercial profit-sharing contract between the provider or providers of funds for a business venture and the entrepreneur who actually conducts the business. The operation of takaful may thus be envisaged as the profit-sharing business venture between the takaful operator and the individual members of a group of participants who desire to reciprocally guarantee each other against a certain loss or damage that may be inflicted upon any one of them.

5.2 Wakalah Model

In *Wakalah* Model, the surplus of policyholders' funds investments – net of the management fee or expenses - goes to the policyholders. The shareholders charge *Wakalah* fee from contributions that covers most of the expenses of business. The fee rate is fixed annually in advance in consultation with Shariah committee of the company. In order to give incentive for good governance, management fee is related to the level of performance.

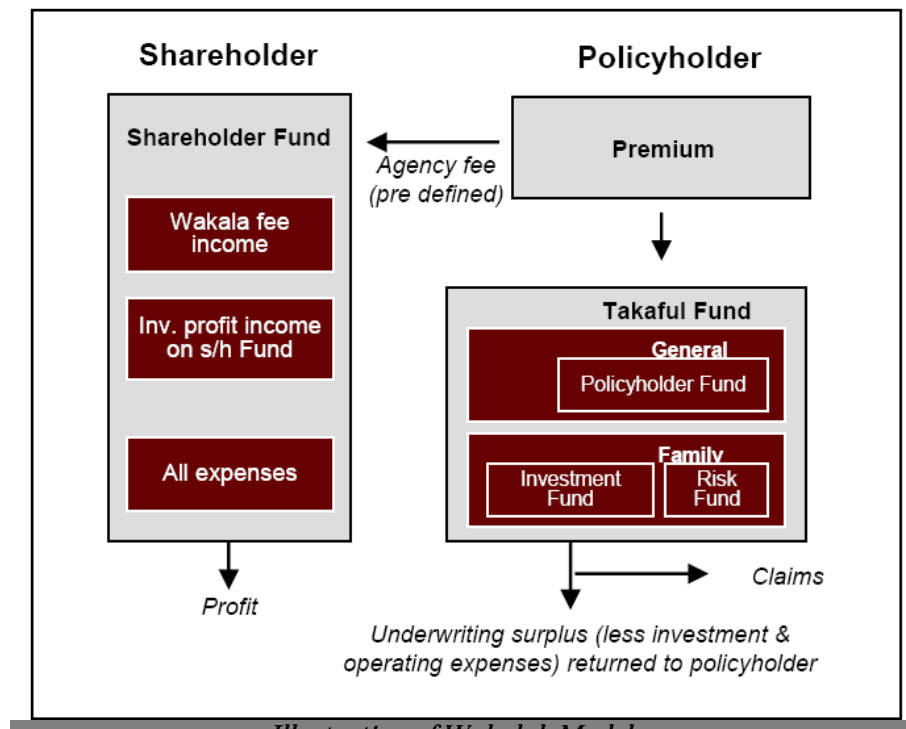


Illustration of Wakalah Model

- Policyholders share all underwriting risk
- Operator (shareholder) is paid a set fee to cover expenses. Fee expressed as a percentage of premium and Takaful fund under management.
- Operator is also required to fund policyholder deficits interest free until repaid from profits

5.3 *Wakalah Waqf Model*

An extension of the *Wakala* Model is the *Wakalah Waqf* Model, in which the risk related component of the Takaful contributions is pooled in a separately formed *Waqf* Pool. The overall Takaful contract is administered by the Takaful operator as a *wakeel* under the *Wakalah* arrangement, while only the investments portion of the *Waqf* Pool is administered by the Takaful Operator as a *Mudarib* under a *Mudarabah* agreement.

6. TAKAFUL COMPANIES

The growth in demand for Islamic insurance over recent years has seen a proliferation of new companies offering Islamic insurance products in these markets. According to the current applicable laws in Pakistan, Takaful Companies (Takaful Operators) are the financial institutions incorporated as Limited Companies registered with the SECP and licensed from Insurance Division of SECP. They are granted permission to conduct General and Family Takaful (Islamic insurance) business in Pakistan for Non-life and Life insurance respectively.

The first Takaful Company to operate in Pakistan was Pak Kuwait Takaful Company Limited, who began its Takaful operations in the year 2005. Whereas, currently there are five Takaful operators comprising of three General Takaful and two Family Takaful Companies, namely.

General Takaful Companies

- i. Pak Kuwait Takaful Company Limited
- ii. Pak Qatar General Takaful Limited
- iii. Takaful Pakistan Limited

Family Takaful Companies

- i. Pak Qatar Family Takaful Limited
- ii. Dawood Family Takaful Limited

7. BENEFITS OF TAKAFUL

Takaful intends to provide with a five in one advantage as categorically spelt out as follows:-

7.1 Insurance Coverage/Protection Benefits

Takaful plans provide cover in the form of mutual financial aid from payment of Takaful benefits to the policyholder or heir(s). The benefits can be divided into two i.e. Family Takaful Plan (similar to Conventional Life Insurance) and General Takaful Plan (General Insurance). Family Takaful offers a maturity plan of 10, 15, 20, 25, 30, 35 or 40 years. Supplementary contracts in the form of hospitalization, accident and permanent total disability may be incorporated in the plan. Other supplementary contracts in the form of 'family rider' may also be attached to the Family Takaful Plan such as Takaful Mortgage Plans, Takaful Plans for Education and Group Takaful Plan.

The various types of General Takaful scheme for both individuals and the corporate sector provided by a Takaful company are shown as follows:

- a) Fire Takaful scheme-basic fire, house owners, house holders, industrial all risks.
- b) Motor Takaful Scheme - motor car, motorcycle.
- c) Accident/miscellaneous Takaful scheme-personal accident/group personal accident, personal accident for pilgrims, all risk, workmen's compensation, public liability, money equipment all risks, employers' liability, plate glass, fidelity Takaful, etc.
- d) Marine Takaful scheme-cargo.
- e) Engineering Takaful scheme-machinery breakdown, erection of all risks, boiler, pressure vessel, contractors all risk, bond.

7.2 Mobilisation of Savings

The birth of Takaful companies is complimentary to the establishment of Islamic banks. It adds to the color of Islamic finance by giving more alternatives to the Muslims to save their money in a safe and more systematic manner. With the existence of Takaful, a Takaful company can mobilize the savings in a safe and profitable manner. As such, Takaful intends to advocate the custom of regular savings for a fixed period with a view to creating a kind of retirement or long-term contingency fund. In sum, a Takaful company plays the role as savings institution and a custodian of money deposited in its custody to serve the future interest of the Muslim community.

7.3 Islamically approved (Halal) Investment Opportunity

In connection to the above (savings tool), a Takaful company will mobilize the savings of the contributors in Islamic-approved counters (Stocks and Shares). In other words, by joining a Takaful plan, the policyholder gains the added benefit or a golden opportunity to invest the money in accordance with Islamic principles.

7.4 Participation in the economy in a collective way

Takaful also invites Muslims, and non-Muslims for that matter, to participate in the economy in the collective and systematic way. As indicated earlier, it refers to a group of people pooling their resources in the spirit of joint benefits and shared responsibilities. Likewise if at the social-level, one can easily collectively help and protect another for the good cause, why not in the economic sphere as well. Each policyholder collectively pool their money in advance in anticipation that the money will be channeled to a good cause, i.e. to assist any person in need of help. In addition, Takaful does not only collectively help others, but also oneself. If one suffers misfortune, it will be a great relief if someone else could share in alleviating it. Ultimately, Takaful is meant for that purpose, i.e. financial, rather than emotional consolation.

7.5 Opportunity to perform good deeds and charitable works

By joining takaful, one is indirectly involved in charity and welfare. In this challenging, by force or voluntarily, one is too busy with never ending mundane pursuits for survival and convenience, to the extent that there is practically no time to physically be involved in charitable and social welfare, although by natural instinct is reflected in one's intention. So, by participating in a Takaful Scheme, that noble intention could be a reality as part of the contribution money (premium) is donated to the Special fund and will be used for any claim by other fellow participants (or the dependants) who are suffering from loss or misfortune. So, this portion of the money does not belong to the policyholder, as upon entering into the Takaful contract, he/she has already promised to donate it to this Special fund. As such, there will be no issue or objection raised if he/she is not given that portion of money when the Takaful policy expires or when the policy holder should survive after the expiration of the policy or in the case when he/she does not suffer from any loss from the defined risk stated in the policy. Furthermore, those who want to make a claim from this Special fund will have to do it in a bonafide manner, without any ulterior or hidden motives of self unjust enrichment as he/she should know that the money that he/she might get from the Takaful operator is a donation exclusively designated to those who really suffer from misfortune. This is in view of the concept of "fortunate many assists the unfortunate few", stemming from this awareness and consciousness, there should be no

unreasonable claims from the participants seeking the compensation money from the operator. As a result, Takaful operators have fewer claims and this will give more surplus to be distributed to the policyholder and the company at the end of the year based on the pre-agreed profit sharing ratio.

8. FREQUENTLY ASKED QUESTIONS

8.1 *Is Risk Protection (insurance) against Tawakkul (total dependence upon Allah (SWT)) ?*

No. Human actions change the Will of Allah (SWT) for our destiny. Whether a person has insurance/Takaful or not has no effect on future events. However, we are instructed to take precautions and then fully trust and depend upon Almighty Allah (SWT). In a *Hadith* narrated by *Anas bin Malik*, one day Prophet Muhammad (PBUH) noticed a Bedouin leaving his camel without tying it. He (PBUH) asked the Bedouin, “Why don’t you tie down your camel”? The Bedouin answered, “I put my trust in Allah (SWT)”. The Prophet (PBUH) then said, “Tie your camel first, then put your trust in Allah (SWT)”. [As quoted in *Sunan At-Tirmidhi*, 1981.]

8.2 *Is all Risk Protection (insurance) Haraam (prohibited)?*

The Fiqh Council of World Muslim League (1398H/1978AD) resolution and The Fiqh Council of Organization of Islamic Conference (1405H/1985AD) in Jeddah resolved that conventional insurance as presently practiced is *Haraam*, and that cooperative insurance (Takaful) is permissible and fully consistent with Shariah principles. Hence, conventional insurance is said to be prohibited for Muslims (because it contains the elements of *Riba*, *Al Maisir*, and *Al Gharar*). By contrast, Takaful provides risk protection in accordance with Shariah based on the principles of *Ta’awun* (mutual assistance), brotherhood, piety and ethical operations.

8.3 *What is Takaful?*

Takaful comes from the Arabic root-word ‘*kafala*’ which means to guarantee, to help, to take care of each other’s needs. Takaful refers to mutual protection and joint guarantee. Operationally, Takaful refers to participants mutually contributing to the same fund with the purpose of having mutual indemnity in the case of peril or loss.

8.4 *How is uncertainty (gharar) eliminated from Takaful contract?*

Uncertainty can never be eliminated; it remains in the Takaful Contract as well. But, since the Takaful contract comes under *Tabarruaat*, the uncertainty (*gharar*) is considered to be within tolerable limits under

Shariah. Insurance, being a contract of exchange (*muawadat*), contains “excessive *gharar*” and is termed as *fasid*.

8.5 All Insurance is a form of Gambling or Wagering, which is forbidden in Islam.

Risk or uncertainty can be divided into: Pure Risk and Speculative Risk. Pure Risk involves the possibility of loss or no loss. For example, damage to property due to fire. Pure Risks are the subject of insurance risk protection and Takaful. On the other hand, Speculative Risk involves the possibility of loss, no loss or gain. For example, venturing into a new business, or gambling on horse race. Speculative Risks that include a potential Gain or Profit cannot be insured. Takaful schemes use the principle of indemnification to compensate for the loss that occurs to a Takaful Participant. Takaful insures only Pure Risks and the claims are only payable in the event of Loss to cover repairs, damage, replacement of property, or an agreed fixed amount.

8.6 Does a takaful company seek to maximize profits and take benefits away from Policyholders?

Takaful operators are mutual or cooperative entities. The goal of Takaful is community well-being and self-sustaining operations, not high profits. Under the Takaful *Mudarabah* Model, surplus (or profits) is shared fairly and equitably between the shareholders and the policyholders (i.e. the ‘Participants’). Under the Takaful *Wakalah* Model, surplus is returned entirely to the Participants.

8.7 Do I need insurance/Takaful?

A Takaful scheme gives us an opportunity to practice the virtues of Islam, including self-purification. *Surah Al Maa'idah* (V.2) says: “Help one another in furthering virtue and *Taqwa* (God-consciousness), and do not help one another in evil and transgression”. In a *Hadith* narrated by *Ahmad and Abu Daud*: Whosoever fulfills the intentions (needs) of his brother, Allah will fulfill his intentions. And Allah always helps those who help their brothers in need. The first Constitution in Medina (622 CE) arranged by Prophet Muhammed (PBUH) contained three aspects directly related to risk protection: social insurance for the Jews, Ansar and Christians; Article 3 concerning 'wergild' or 'blood money'; and provision for *Fidyah* (ransom) and '*aaqila*'. We should follow his (PBUH) example to meet our needs and social obligations.

8.8 Do Takaful contributions entail a higher rate than the conventional insurance premium?

No. Takaful companies are as competitive as their conventional insurance counterparts. Opting for Takaful will not make you pay any higher costs, as such.

8.9 Can Takaful cover theft of my car?

Yes, Takaful companies offer the same variety of products offered by any insurance company, whether it is Fire, Marine, Motor, etc. In addition, most of the Takaful operators have the expertise and experience to deliver tailor-made specific solutions for the benefit and convenience of their clients. The only exceptions are those risks that are not in conformity with the Shariah, e.g. breweries, casinos etc.

8.10 How will I get a claim from a Takaful company?

All procedures, including claims, are the same as in conventional insurance companies. The difference lies in the nature of the contract, not in the procedures.

8.11 How is it ensured that all activities of Takaful companies are Shariah compliant?

All Takaful companies are governed by the SECP's Takaful Rules, 2005 that require the Takaful operators to constitute a "Shariah Board" comprising of Shariah Scholars of repute. Moreover, all Takaful companies have to undergo a "Shariah audit" as well, in addition to the customary Accounting audit, in each accounting period.

8.12 Is Takaful transacted in other countries?

Takaful is a new phenomenon in Pakistan. The first Takaful company was established in 1979 - The Islamic Insurance Company of Sudan. Now, there are more than 100 Takaful Companies in over 20 countries.

8.13 How many Takaful models are there?

In Islam, there is room for diversity within certain prescribed parameters. Over the centuries, several Takaful Models have evolved which are approved by the Islamic scholars. While they all share the same fundamental goal of cooperative risk sharing, these models differ slightly in legal structure and organizational operations. Takaful Models are usually described by the Islamic contracts used; namely, *Hibbah*, or 100% *Tabarru'* [Sudan], or *Al Mudarabah* [Bahrain/Malaysia], or *Al Wakalah* [Saudi Arabia], or *Wakala/Waqf* [Pakistan].

8.14 What Takaful Model is followed in Pakistan?

According to the SECP's Takaful Rules, 2005, in Pakistan a Takaful product shall be based on the principle of *Wakala* or *Mudaraba* or both. Therefore, Takaful companies in Pakistan follow a refined hybrid model named “*Wakala – Waqf*” model. It is a *Wakala* model in which the fund is made a separate legal entity by virtue of it being a *waqf*. The relationship of the participants and the operator is directly with the *Waqf* fund. The operator is the ‘*Wakeel*’ of the fund and the participants pay contribution to the *Waqf* fund by way of *Tabarru* (contribution).

8.15 How is Takaful companies’ investment income Riba-free?

Unlike insurance companies, whose investment income may contain *Riba*, Takaful companies invest funds in Property, Islamic Banks, Shariah compliant Stocks and other Shariah approved securities like Sukuk bonds etc.

8.16 Is Takaful just a change of label?

Although the end result is the same since both insurance and Takaful aim to provide compensation against possible losses, yet the crucial difference lies in the way that each does this. The notion “ends justify means” does not hold when it comes to Islam where both the ends as well as the means have to be in order. Chicken can either be slaughtered or given an electric shock; both achieve the same end, a dead chicken. However, the former way makes the meat Halaal for eating whereas the later renders it Haraam.

8.17 What is meant by Surplus Sharing?

The Takaful Operator acts only as the Wakeel of the Waqf Fund. If, at the end of the year, there is surplus in the Fund (i.e. after adding all its income and deducting all the outgo), such surplus will be distributed amongst the participants proportionately after taking into account any claim benefits already availed.

8.18 Is there a single Participant Takaful Fund or separate PTFs for each class of business?

A General Takaful operator may create a single PTF or separate PTFs for different classes of business.” (Section 8(5) of the SECP's Takaful Rules, 2005). The surplus is thus calculated in accordance with the practice adopted.

9. TAKAFUL OPERATORS IN PAKISTAN

S.No.	Takaful Operator	Estd. Since	Contact Details
1	Pak-Kuwait Takaful Company Limited 4th Floor Block A, Finance and Trade Centre, Shahrae Faisal, Karachi	2006	Tel: +92-021-35630707-16 Fax: +92-021-35630699 Web: www.pktcl.com
2	Pak Qatar General Takaful Limited Suite # 402 – 403, Business Arcade, Block 6, PECHS Sharae Faisal, Karachi	2007	Tel: +92-021-34380357-61 Fax: +92-021-34386453 Web: www.pakqatar.com.pk
3	Takaful Pakistan Limited 2nd & 3rd Floors, Dadex House, 34-A/1, Block-6, P.E.C.H.S. Shahrah-e-Faisal, Karachi	2007	Tel: +92-021-111-875-111 Fax: +92-021-34373195-6 Web: www.takaful.com.pk
4	Pak Qatar Family Takaful Suite # 102-105, Business Arcade, Block 6, PECHS Sharae Faisal, Karachi	2007	Tel: +92-021-34311747-56 Fax: +92-021-34386451 Web: www.pakqatar.com.pk
5	Dawood Family Takaful 1701-A Saima Trade Towers, I.I. Chundrigar Road, Karachi	2008	Tel: +92-021-111-338-786 Fax: +92-021-32277188 Web: www.dawoodtakaful.com

10. GLOSSARY OF TAKAFUL TERMS

The language of Takaful can be quite complex and confusing. Below are some commonly used insurance terms and their meanings. This information is for educational purposes only and should not be relied upon to form professional opinions on coverage issues.

A

Assurance

Insurance in a conventional insurance policy. It is the “sharing” of risk that comes with mutual solidarity and guarantee as opposed to the “transfer” of risk that conventional insurance provides.

Average Clause

Stipulates that a takaful fund is only liable for such proportion of the loss as the sum covered bears to total value at risk.

C

Claims

Notification to a takaful operator that payment of an amount is due under the terms of the certificate.

Claims Ratio

The ratio of net claims incurred to earned contributions.

Contribution

Premium in a conventional insurance policy. It is the payment of an amount by a Participant to the Takaful Protection Pool, whether direct, through intermediaries for the purpose of mutual protection and assistance.

D

Designated Charities

In the event that there is a surplus in the Takaful Protection Pool after all expenses have been deducted, then that Net Surplus will be donated to a

designated charity or charities. Currently, those charities are; United Nations International Children's Emergency Fund (UNICEF), and/or the International Federation of the Red Cross and Red Crescent Societies (IFRC). The designated charities may be changed from time to time at the discretion of the Wakeel's Oversight Committee provided such change is approved by the Shari'ah Supervisory Board.

E

Earned Contribution

Net contributions less provision for reserves for unearned contribution (RUC) at the year-end plus the RUC at the beginning of the year.

Excess of Loss Treat

A type of retakaful treaty which provides that the retakaful operator pays all or a specified percentage of a loss arising from a particular occurrence or event (frequently of a more or less catastrophic nature) in excess of a fixed amount and up to a stipulated limit.

Excess

Deductible in a conventional insurance policy. It is the first amount that you have to pay on your own account towards each claim.

Event of Loss

An event that gives rise to a Loss as defined in the Policy. Loss means a loss to a Participant that is subject to compensation under the terms and conditions of the Policy.

F

Facultative Treaty

A retakaful contract under which a ceding takaful operator has the option to cede and the retakaful operator has the option to accept or decline individual risks.

G

General Takaful

Protection to participant against losses arising out of perils such as accident, fire, flood, liability and burglary.

Gharar

Arabic for uncertainty. One of three fundamental prohibitions in Islamic finance (the other two being riba and maisir). Gharar involves an unacceptable level of uncertainty or contingency in a contract. The prohibition on gharar is often used as the grounds for criticism of conventional financial practices such as short selling, speculation and derivatives.

Gross Direct Contributions

Contributions on original gross rate charged to clients in respect of direct takaful business Without any deduction for commission or brokerage.

Group Family Takaful

Family takaful (usually without medical examination) on a group of people under a master Certificate. It is typically issued to an employer for the benefit of employees, or to members of an association.

H

Hibah

Gift

I

Indemnity

Restoration to the claimant of a loss by payment, repair or replacement.

Individual Family Takaful

A contract that provides takaful benefits payable to an individual upon death/total permanent disability or periodic income to participant upon retirement.

Investment-linked Takaful

A contract where the certificate benefits at any time vary according to the value of the underlying assets at the time.

Islamic Finance

Financial services that meet the requirements of the Shari'ah, or Islamic law. While designed to meet the specific religious requirements of Muslim consumers, Islamic banking is not restricted to Muslims: both the financial services provider and the consumer can be non-Muslim as well as Muslim. Also called Islamic banking or Islamic financial services.

Ijara

An Islamic lease agreement. Instead of lending money and earning interest, ijarah allows the financial institution to earn profits by charging rentals on the asset leased to the consumer. Ijarah wa iqtinah extends the concept of ijarah to a lease and purchase agreement.

M

Maisir

Arabic for gambling. One of three fundamental prohibitions in Islamic finance (the other two being riba and gharar). The prohibition on maysir is often used as the grounds for criticism of conventional financial practices such as speculation, conventional insurance and derivatives.

Medical and Health Takaful

A contract that provides specified medical treatment benefits such as the cost of hospitalisation, surgical and physician consultation fees against risks of a person being diagnosed with certain illnesses or having injury arising from an accident.

Mortality Table

A statistical table showing the death rate at each age, usually expressed as the number of deaths per thousand.

Mudaraba

A Mudarabah is an Investment partnership, whereby the investor (the Rab ul Mal) provides capital to another party/entrepreneur (the Mudarib) in order to

undertake a business/investment activity. While profits are shared on a pre-agreed ratio, loss of investment is born by the investor only. The mudarib loses its share of the expected income.

Mudharib

Entrepreneur

Murabaha

A Murabaha is a purchase and resale transaction. Instead of lending money, the capital provider purchases the desired commodity from a third party and resells it at a predetermined higher price to the commodity user. By paying this higher price over installments, the commodity user has effectively obtained credit without paying interest.

Musharaka

A Musharaka is a partnership financing structure where profits are shared as per an agreed ratio whereas the losses are shared in proportion to the capital/investment of each partner. In a Musharaka, all partners to a transaction contribute funds and have the right, but not the obligation, to exercise executive powers in that project, which is similar to a conventional partnership structure and the holding of voting stock in a limited company. This equity financing arrangement is widely regarded as the purest form of Islamic financing.

N

Net Claims Incurred

Net claims paid less provisions for outstanding claims beginning of the year plus provisions for outstanding claims at the end of the year.

Net Contributions

Gross contributions less all retakaful contributions payable.

Net Investment Income

Returns on investments less rates and taxes.

Net Surplus

The net difference that is created in the Takaful fund after all expenses and management fees for the cost of administration have been subtracted.

O

Operating Protocol

A document that outlines the terms and conditions under which the operator (Wakeel) and participant of the Takaful Policy agree to the guidelines and principles set forth between the two parties. This document also specifies the particular relationship in place between all participants, operators and administrators and ensures that all transactions that take place are done so according to Shari'ah law and dictates that all investments must be Shari'ah compliant.

P

Participant

The Named Insured (Muwakkil in Arabic) in a conventional insurance policy. The participant is the contributing party to the Takaful policy who is covered through the mutual protection and solidarity of the Takaful policy.

Participants' Account

An account to credit a portion of contributions from the participant for the purpose of investment/savings

Participants' Special Account

An account to credit a portion of contributions from the participant for the purpose of tabarru'

Period of Takaful or Policy Period

The length of time for which the Takaful protection will be effective.

Proportional Treaty

A contract under which a takaful operator and a retakaful operator participate proportionately in the contributions and losses on every risk that comes within the scope of the contract.

Q

Qard

Loan

Qard Hasan

An interest free loan from the Wakeel to the Takaful Protection Pool in order to meet any shortfalls that are created in the fund.

R

Rabbul Mal

Capital provider

Ra'sul Mal

Takaful Contribution

Retention Ratio

The ratio of net contributions to gross direct and retakaful accepted contributions less retakaful within Malaysia.

Riba

Interest generated in a conventional loan. The legal notion extends beyond just interest, but in simple terms Riba covers any return of money on money - whether the interest is fixed or floating, simple or compounded, and at whatever the rate. Riba is strictly prohibited in Islam. Investments made within a Takaful policy always avoid Riba in its financial transactions.

Rider

An attachment to a certificate that modifies its conditions by expanding benefits.

S

Shari'ah

Islamic law as revealed in the Qur'an and through the example of Prophet Muhammad (PBUH). A Shari'ah compliant product meets the requirements of Islamic law. A Shari'ah board is the committee of Islamic scholars available to an

Islamic financial institution for guidance and supervision in the development of Shari'ah compliant products.

Shari'ah advisor or scholar

An independent professional, usually a classically trained Islamic legal scholar that advises a financial institution on the compliance of its products and services with the Shari'ah, or Islamic law. While some financial institutions consult individual Shari'ah advisors, most establish a committee of Shari'ah advisors (often know as a Shari'ah board or Shari'ah committee).

Shari'ah compliant

An act or activity that complies with the requirements of the Shari'ah, or Islamic law. The term is often used in the Islamic banking industry as a synonym for Islamic—for example, Shari'ah compliant financing or Shari'ah compliant investment.

Sum Covered

Limit of liability in a conventional insurance policy. The amount shown in the Schedule being the maximum amount that the Risk Fund will pay for any one claim. The Sum Covered must be high enough to cover the cost of rebuilding the Building in the event of an Incident that completely destroys it.

Sukuk

Sukuk is the Arabic name for a financial certificate but can be seen as an Islamic equivalent of a bond. However, fixed income, interest bearing bonds are not permissible in Islam, hence Sukuk are securities that comply with the Islamic law and its investment principles, which prohibits the charging, or paying of interest. Sukuk is a certificate of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or investment activity.

Surplus at Valuation Date

Excess of the takaful fund carried forward over the actuarial liabilities of a takaful fund of family takaful business.

T

Tabarru'

Premium in a conventional insurance policy. An Arabic word for donation, gift or contribution. In the Takaful contract, this is the amount contributed for the purpose of participating in Takaful scheme.

Tijari

Commercial business.

Takaful

Islamic insurance. Structured as charitable collective pool of funds based on the idea of mutual assistance. Takaful protection policies are designed to avoid the elements of conventional insurance (i.e., interest, uncertainty and gambling) that are problematic for Muslims. Takaful literally means mutual protection through co-operative risk sharing. It is insurance that avoids prohibited elements of conventional insurance in accordance with the laws of Shari'ah.

Takaful Policy

Policy as defined in conventional insurance. The agreement entered into between the operator and the participant(s) for the purposes of Takaful insurance.

Takaful Protection Pool

The total sum of the Contributions received by the Wakeel from the Participants together with investment returns generated thereon (if any) and which has been established voluntarily for the purpose of mutual protection and assistance of the Participants.

Ta'min

Insurance

Total Loss

A loss of sufficient size so that it can be said there is nothing left of value.

U

Underwriting Profit / Loss

Earned contribution income less net claims incurred, commissions and management expenses.

Unearned Contribution Reserves

Contributions already received in respect of risks which are still unexpired at the end of the accounting period.

W

Wakeel or Operator

The insurance company who underwrites, administers and manages the Takaful program on behalf of the participants. For the Zayan Takaful Homeowners Program, the Wakeel is Lexington Insurance Company, one of the leading Property & Casualty insurers in the United States.

Wali

Guardian

Wakalah

Agent-principal relationship, where a person nominates another to act on his behalf.

Wakil

Agent

Wasi

Executer

~Ends here~