

# Frequently Asked Questions - Takaful

## Question

What is Takaful? How does it work?

Insurance serves a very important social need (general and life insurance) and commercial need (commercial insurance). In conventional insurance, interest, gambling and Gharar makes it unacceptable under Islamic principles. In Takaful system, the shareholders establish the Takaful Company. It is based on the concept of Mutual insurance.

Instead of giving premiums, the participants give contributions/donations which together constitute a pool of funds. From this pool of funds, Takaful companies invest in mutual funds, equity markets, Sukuk, real estate etc to increase the value of their funds collected by way of Tabarru (donations to the fund by the participants).

If a particular participant goes through a catastrophe (i.e. accident, theft etc) for which that participant and others mutually insured themselves, the participant facing the catastrophe is compensated from the pool of funds. If the pool of funds has any surplus at the end of the year, the surplus is given back to the participants.

## Question

What are the different models of Takaful used currently?

There are many Takaful models in operation, but the two most important ones are Wakalah and Mudarabah.

In Wakalah model, the Takaful Company, also called Takaful operator only gets a stipulated fund management fee just like an asset management company does for its mutual funds.

In Mudarabah model, the Takaful Company invests its own funds too and agrees to a profit sharing ratio with the participants of the pool. Any surplus/profit in the fund is then distributed on the basis of a pre-agreed ratio.

## Question

Why is conventional insurance prohibited?

In conventional insurance, interest, gambling and Gharar makes it unacceptable under Islamic principles. Interest gets involved in conventional insurance as insurance companies invest in banks and also invest in interest bearing financial instruments like sovereign bonds, corporate bonds etc. Furthermore, in products based on the concept of annuity, the policy holder receives payment over and above what he gave in the form of premiums.

The element of Qimar gets involved in conventional insurance by way of disparity in payoffs between policy holder and insurance company. Whereas, the policy holder pays regular premiums, the payoffs to policy holder from insurance company are not certain and are tied to other events.

Question 4: How are contributions dealt in Takaful?

Contributions are regarded as donations, an act of 'Tabarru' in Takaful. The funds received are collected in a fund. That fund is managed by an operator. The operator charges management fee in Wakalah model for services rendered for the investment managements. Eventually, after paying any compensation for the member, if surplus amount remains in the fund, it is distributed among the participants, the mutual insurers.

## Question

How does Wakalah model work in Takaful?

In Wakalah model, the funds received from the participants are collected in a pool. The pool comprising funds donated by participants is then managed by the Wakeel (Takaful Operator). The management includes planning and executing the investment decisions that focus on growing the pool of investment so that more and more participants can be compensated for their losses and accidents. Moreover, if any surplus remains, it is distributed among the participants. The Takaful operator is entitled to receive a management fee for its agency services.

## Question

How does Mudarabah model work in Takaful?

In Mudarabah model, the funds received from the participants are collected in a pool. The pool comprising funds donated by participants is then managed by the Takaful Operator. Takaful operator also invests its own funds in the pool. The profit/surplus is distributed among the participants and Takaful Operator (Mudarib) as per pre-agreed profit sharing ratio.

## Question

Is insuring against the concept of ‘Tawakkul’?

Insurance is not against the concept of Tawakkul. Islamic insurance is based on the concept of mutual insurance which resembles with concept of ‘brotherhood’. ‘Tadbeer’ is also allowed in Islam and there are various ahadith & traditions which point to this understanding. Narrated by Aamer bin Saad bin Abi Waqas the Prophet (pbuh) said: “Verily it is better for you to leave your offspring wealthy than to leave them poor asking others for help”. In addition to that, Anas Bin Malik reported that one day a Bedouin came to the Prophet (pbuh) on a camel and asked him: “Can I leave the camel alone (without tying it to any tree) and trust in Allah?” the Prophet (pbuh) said: “Tie your camel first, then put your trust in Allah” (Tirmizi).