TAKAFUL AND CONVENTIONAL INSURANCE: SIMILARITIES AND DIFFERENCES

التكافل والتأمين التقليدي: التشابه والاختلاف

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Abstract:

There are many sounds raised why we need Takaful if the treatment of both is same. So this paper attempt to clarify the concept of Takaful and conventional insurance and their objects. This paper collects the differences and similarities between them in one paper. This study undertakes library to search in books and other papers of science. That is related to Takaful and insurance area. As a result, the study found there are a big differences between an Islamic insurance (Takaful) and conventional insurance perceives depends on Shari'ah. Also Takaful depends on donation contract. Whereas, some conventional insurance companies depend on mutual contract. At the same time there are some similarities in goals and all of them operate the money of insurance in pooling, but the relationship between insurers and insured was different.

Keywords: Takaful; Insurance; Family insurance; general insurance..

JELClassificationCodes: …, …, …

ملخص:

هناك العديد من الاصوات التي أثيرت لماذا نحتاج إلى التكافل إذا كانالتكافل والتأمين التقليديعملهما واحد. لذا تحاول هذه الورقة توضيح مفهوم التأمين التكافلي والتقليدي وأغراضهما. تجمع هذه الورقة الاختلافات والتشابهات بينهما. وذلك من خلالالبحث في الكتب والأوراق العلمية المختلفة فيما يتعلق بالتكافل والتأمين التقليدي. ونتيجة لذلك ، وجدت الدراسة أن هناك اختلافات كبيرة بين

التأمين الإسلامي (التكافل) والتأمين التقليدي. حيث أن التكافل قائميلتزم بالشريعة ويعتبر من عقود التبرع. غير أن التامين التقليدي لا يلتزم بأي ضوابط ويعتبر من البيوع. بالمقابل هناك بعض أوجه التشابه بينهما في الأهداف وأيضاً من حيث استثمار أموال التأمين وأنواع التامين سواء التأمين على الحياة او التامين العام.

كلمات مفتاحية:التكافل، التأمين, التأمين العائلي,التأمين العام..

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Introduction:

The objective of the study: is to manifestation these objectives:

- To provide more explanation about concept of Islamic insurance "Takaful".
- To highlight similarities and differences between Takaful and conventional insurance.
- To show the we need to arrange Takaful.

Research questions:

- What is Takaful meaning?
- What are the similarities between Takaful and conventional insurance?
- What are the differences between Takaful and conventional insurance?
- Are all conventional insurance models prohibited? (if prohibited)why?

Verily! Allah will not change the condition of a community if they do not change their state themselves.(.*Holy Qura'an,Surah Ar-Rad 13:11*)

The idea and practice of Takaful is not new. It was practiced during the time of the Prophet Muhammad (PBUH)by its adoption of the concept of Aqilah (Salman, Majdi, Rashid, Nu, & Htay, 2015). Islamic insurance

(Takaful) is nearly as old as the Islamic banking system and dates back to 1979, when the concept was launched in Sudan and later in Saudi Arabia(Rahim & Wahab, 2007). Today, more than 300 Takaful companies are operating around the world(Malik & Ullah, 2019). However, conventional insurance can be traced back to 1667, the year after the Great Fire of London(Dahnoun, 2018). Basically, insurance is a form of risk management primarily used to guard against the risk of uncertain loss. Hence this paper try to clarify the concept and goals of Takaful. Also it attempts to determine the key differences / similarities between Islamic insurance and conventional insurance. That was made Takaful an alternative insurance. There are many sounds raised why do we need Takaful if the treatment of both is same. So this paper try to clarify the concept of Takaful and conventional insurance and their objects. This study undertakes library to search in books and other papers of scientific that are related to Takaful and insurance area. In a result, the study found there are a big differences between Islamic insurance (Takaful) and conventional insurance. Previous depend on shari'ah that means all activities must follow the Islamic rules. However conventional insurance is free-system. And Takaful depend on donation contract whereas, conventional banks depend on mutual contract. In the same time all of them operate the money of insurance in pooling but the relationship between insurers and insured was difference. The concepts of mutual assistance and charity often come to mind when the concept of Takaful is mentioned. This is understandable given that Takaful played the role of an essential risk-sharing mechanism in Muslim history. Takaful is social corporation to safe them self from the risk in live. And to reduce the heavy risk by participate other people to avoid the risk like what in the first Islam happen Agilah which when some kill a person in mistake killer family bear the blood money on behalf. But when trading was beginning and growth there are difference types of risk faced trading activities. Thereafter Takaful appeared to reduce these risks and share risks among them. And because conventional insurance in live have been used which based on frees-system and not comply with shari'ah rules. Scholars of Islam attempt to create new alternative to be completely compliance with shari'ah rules that is Takaful. This paper divided to four sections second section shows the concept and objects of Takaful and conventional insurance because Takaful build based on it. Third section shed light the similarities and differences between Islamic insurance "Takaful" and conventional insurance in difference aspects, form of institution and ultimate goals, the operations of investment and the relationship between insurer and insured. Fourth section explanation the causes led most scholars prohibited conventional insurance. Five section focused on the result of discussion. The conclusion section of this study shows key findings and main gaps between conventional insurance and Islamic insurance to share knowledge and the reader will free to select the best kind of insurance.

Discussion:

I. Literature review:

There are many studies focused on the differences between Islamic insurance Takaful and a conventional insurance like (Hussain, 2011) discussed the concept and operating differences deeply. And the other study (Rahman, Ali, Seman, Marhaini, & Ahmad, 2008) comparison between the behavior of people to choose purchasing people between Takaful insurance or a conventional insurance in Malaysia. The study found the auto insurance is better than auto Takaful in all factors that influence whereas, when religion was factored in the Muslim undergraduates ranked it as the top item that makes a difference between auto Takaful and insurance. Also (Khan, Ahmad, Ali, & Scholars, 2011) shed light only the operation of Takaful comparing with conventional insurance. And (Dawabeh, 2016) in his paper defined the concept of Takaful and attempted to determine the challenges and cited the essential differences between Takaful and conventional insurance. However, it is still that there are confusing in the ways of operating of insurance and Takaful hence in this paper elaborate and allocate the differences and similarities to participate to spread the knowledge.

II. Background:

Conventional insurance can be traced back to 1667, the year after the Great Fire of London(Dahnoun, 2018). Basically, insurance is a form of risk management primarily used to guard against the risk of uncertain loss.. And they established insurance to avoid the large losses by sharing the risk among society. And this idea is a good to protect all society. However, years after years the conventional insurance improved and people attempted to benefit from the risk fund in investment and they endeavor to operate it. So they established special companies to cater society and this company bear the risk against premium. Hence the insured protect his equity through transfer the risk to that company. And the companies endeavor to realize some goals the first one is maximizing profit for the shareholders. And the second goal is to protect the insured. According, of these deviations some Islamic scholars started to study the Islamic history and they attempt to create an insurance depend on the conventional insurance through eliminating the element which conflicts with Shari'ah rules. And return to good attitude. Thus, modern Takaful dates back to 1979, when the concept was launched in Sudan and later in Saudi Arabia (Rahim & Wahab, 2007). Therefore differences between Takaful and conventional insurance is very sensitive. So through clarifying the essential information of both to know the differences because the goal of insurance and types are similar but there are some aspects harming the society and economy and reflect to the Shari'ah rules like gambling and gharar and the relationship between parties of insurance.

III. The concept and definition:

A- Conventional insurance:

Conventional insurance is defined as “a device for reducing risk by combining a sufficient number of exposure units to make their individual losses collectively predictable, this predictable loss is then shared with or distributed proportionately among all units in the combination” (Mehr, 1986) through transfer risk from the insured to the insurance company against a premium.

Features of conventional insurance:

There are three functions that appeared the nature of insurance number one risk transfer mechanism that means that is transferring risk from the insured to the insurance company against a premium. So the contract is mutual contract. Second is creating a common pool, the conventional insurance to a calculate insurance policy through managing common pool and the insurer benefit of the large number law depends on this way and the insurer decides the amount of premium. The third is sitting equitable premium that means Charging equitable premium ensures sufficient funds in the pool which enable the insurer to take risk of issuing different types of coverage (Malik & Ullah, 2019)

The objects of conventional insurance:

According to (Malik & Ullah, 2019) Insurance started in Italy to avoid the risk of life by establishing burial societies. And all the society share in this by paying the same premium. However, after that, many people canceled their insurance because they have view against the equitable share then the insurer company try to calculate the premium accordingly to the risk to be more justice. And the company endeavors to maximize the profit for the shareholders.

Operating of conventional insurance:

The source of law and regulations in conventional insurance is set by the state and are thus man-made. The insurance company accepts premiums from the insured; in exchange for indemnity against risks that may not occur, at a level which it predicts will cover claims and result in a definite profit

B- Takaful (Islamic insurance):

Word al-Takaful is derived from a verb, kafala, which means to help or to take care of one’s needs. Based on tabarru contract. Takaful 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 (M. K. Hassan & Lewis, 2007). Historically, this concept existed during the time of Prophet

Muhammad among the Arabs, whether by means of the tribes assisting each other to pay the *diyah* (blood money) under the tribal system of al-aqilah (payment of blood money to the heirs of the murdered) or through *al-nahd* (sharing of provision) (Tijani, 2014).

The objective of Takaful:

The main purpose of Takaful under the Islamic system, is to bring equity to all parties involved, and the objective of the contract is to help the policyholder through bad times. Profit earnings is not the main goal, while sharing any profits generated incidentally, is acceptable (Hussain, 2011).

Features of Takaful insurance:

Basically the characteristics of Takaful distinguish it from other insurance. Number one is every participant has two subjects one is an insurer and another is insured that means there are no any ghabn in this contract because the ultimately all the fund remains will return to the participants. The second features are no any profit because they are participating to share in any risks, but they do not ambitious to realize profits. Hence at the end of the year they destitute the remained fund to the all participants. Third, there are no any necessity for capital because this Takaful product only need numerous of people to bear the risks and have agree about face the risk to gather. And the cost of Takaful is not big because there are no large expense and there are no goals to gain profit (Bahluli, Fisal &Khwailed, 2012).

Operating of Takaful:

The source of law and regulations in Takaful Islamic insurance is set by Shari'ah rules that derived from the Qur'an and Sunnah and consensus and Qiyas by text interpretation from Muslim scholars. There are three parties contain in this Takaful namely, participants that give premium and collect it to pool to compensate people who face risks or losses there are three elements present in conventional insurance that do not conform to the requirements of the Shari'ah law:

1- Riba This refers to the interest factor present in the investment activities of conventional insurance companies. The policy loan in conventional life insurance is in fact a Riba based transaction. Islam prohibits any investment activities which are interest based on alcoholic beverages and non-Halal products (Matsawali et al., 2012).

2- Al-Gharar This refers to 'unknown' or 'uncertain' factors in a conventional insurance contract. In conventional insurance policyholders are not informed on how profits are distributed and in What the funds are invested in. In a Takaful operation, this is based on the Mudarabah concept, the distribution of profits to the operators and the participants are clearly outlined in the contract (Matsawali et al., 2012).

3- Al-Maysir This is the 'gambling' element and is said to derive from the 'Gharar' element. In conventional insurance the policyholder stands to lose all the premiums paid if the risk does not occur. On the other hand, he stands to get more should a misfortune happen whilst paying a small amount premium. In Takaful, even though the risk does not occur, the participant is entitled to get back the contributions that he has paid. Should the risk occur, he will be paid from his premium fund plus the pool of funds from the 'donation' of other participants (Matsawali et al., 2012).

4- And there are some contracts coordinate between the participants and the operator of risk fund like agency doctrine. That means operator only work on behalf the shareholders against percentage of profit or fee.

IV. The differences similarities between insurance and Takaful:

A. Similarities

1- Similarity of functions between the insurance and Takaful products cannot be denied and should be expected given that the concept of mutually helping each other, which is found in insurance, is also a concept applauded by Islam (Rahman et al., 2008).

2- Insurance and Takaful are both risk-mitigation tools, but there are differences in how they work. The mechanism of Takaful is permissible, while the mechanism of insurance is not permissible (Malik & Ullah, 2019).because it has gharar and ignorance.

3- Both Takaful and conventional insurance policies work on the same basic system; the pooling of funds to manage the risk of a group of people (Dahnoun, 2018).
4- Insurance and Takaful deal with only pure risks, such as death, car theft or fire. They do not cover speculative risks (Malik & Ullah, 2019).
5- Takaful and insurance deal with financial risk, not with non-financial risk.
6- In principle, insurance and Takaful deal with particular risks only Therefore, any risk-mitigation system that does not contain prohibited elements can be acceptable from the Shari'ah point of view (Malik & Ullah, 2019).
7- According to (H. A. Hassan, Abbas, & Zainab, 2018)there are two main types of Takaful that is general Takaful and family Takaful the general Takaful contains:
   - Motor insurance
   - Marine insurance
   - Home insurance
   - Workmen insurance
   - Accidental insurance

   And family Takaful contains:
   - Life insurance
   - Takaful education plan
   - Takaful mortgage plan
   - Group Family Takaful
   - Medical benefits and group hospitalization

   These types like what in an insurance company.

B. **Differences:**

1- Nature of contract:

Insurance is a sale and purchase agreement in which a client buys cover (a sum assured) from the insurance company by paying a premium. The sum assured may be the value of a car, a building or an item of equipment (among other things). It may also be the contractual amount that a company has to pay for the client’s family if the client dies. In Takaful, there is a contract of tabarru, which means donation.

Participants contribute donations to a common fund, which compensates them if any event covered occurs. Therefore, we can say that Takaful is a tabarru-based contract, whereas conventional insurance is a contract of compensation (aqd mua’wza). All sale and purchase contracts are aqd mua’waza (Malik & Ullah, 2019).

2- Risk sharing versus risk transfer mechanism:

The amount given by the participants in the Takaful fund is called contributions, not premiums. This is because they are based on the concept of tabarru, contribution, donations. Rather than purchasing cover in exchange for premiums.

3- Owner of risk fund:

In conventional bank the risk fund is equity of shareholders and the shareholders compensate the insured if there are risk occurred, but if there are no any risk the risk fund represent profit for the insurance company. But in Islamic insurance the risk fund was owned by participants therefore the insurance company is an agency operate the fund and investment in different activities versus an agency fee or agree percentage of the profit if contract between them Mudarabah model or other models.

4- Ethical and rules of operation:

Takaful follow the Shari'ah rules so there is the Shari'ah board or Shari'ah advisor that is an integral part of any Takaful arrangement. The Shari'ah board supervises the activities of the operator from a Shari'ah perspective. This may include:

• Vetting products

• Checking the Shari'ah compliance of investments

- Checking the Shari'ah compliance of distributing the surplus among participants

on conventional insurance, no such supervision takes place and there are no laws governing it (Matsawali et al., 2012).

5- Expectation of insured:

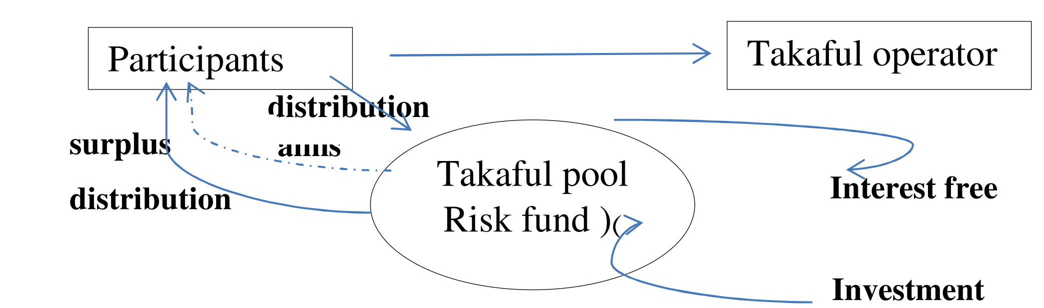
The insured is careful not to cause accidents. Because that risk fund comes back in terms of retrieval The surplus and its distribution to him and others participants. However, in conventional insurance the insured is not interested in accidents either happen or does not happen as it pays the premium Nothing will be returned to him whether released Incident or not. (Dwabeh, 2016) if the risk happens the insurance company compensate him accordingly to term.

6- Accounting books:

with Islamic insurance companies, there are two accounts, one of the participants and other for the shareholders' equity. So the profit or loses return to participant and part of them to shareholders, but in conventional insurance there is only one account special for shareholders and the resultant profit or loses distribute between shareholders (Dwabeh, 2016).

7- Operating of risk fund:

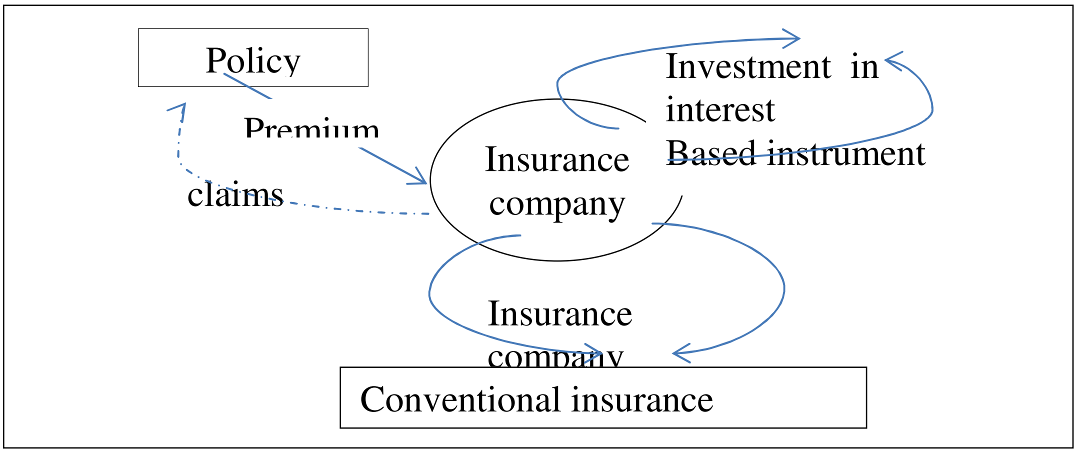
Insurance Takaful is operated by some of Islamic models that depend on Shari'ah rules. In general, there are three models and their modifying or hybrid two kinds like Wekalah, Mudarabah, Wekalah Mudarabah hybrid, Wagif and Mudarabah Wagif hybrid we can show the one kind of them to discover the difference between them .(Khan et al., 2011)



Takaful operation wekalah model

Sources:(Khan et al., 2011) **Page 283.**

Conventional insurance operates in such a way that premium is paid by policyholders to the insurance company and then this amount is invested by the insurance company in interest bearing or non-sharia compliant investing areas. The amount of interest and profit is received by insurance companies and then surplus is retained in the company without distributing it among policy holder and only claims are met with this surplus (Khan et al., 2011).



Sources:(Khan et al., 2011) **Page 283.**

8- Supervisory and auditing:

In conventional bank's auditing is to ensure the investment and all transactions under the global and accounting standards. In Islamic auditing not it is not enough. Hence, in Islamic insurance Takaful established a supervisory Shari'ah board to ensure that difference transaction comply Shari'ah rules (Yazci, 2020).

V. Why conventional insurance (special trading insurance) is prohibited:

The conventional insurance is prohibited because it contains elements that is forbidden in Shari'ah like:

Reba: Usury (Interest): As the insured, on his death, is entitled to get much more than he has paid. Furthermore, insurance funds invested in financial instruments such as bonds and stocks contain an element of interest (Al-salih, 2014).

Pharar (uncertainty): Uncertainty due to: whether the payment will be accepted as promised, the amount to be paid is not known as well as the time it will occur. In addition, when a claim is not made, the insurance company may acquire all the profits whilst the participant may not gain any profit at all. The loss of premiums on cancellation for instance, of a life insurance policy by the policyholder, or the condition of charging a customary short period in general insurance, whereas only a proportional refund is made if the insurance company terminates the cover (Al-salih, 2014).

Maysir(gambling): The participant contributes a small amount of premium expecting to gain a large sum, the participant loses the money paid for the premium when the insured incident does not occur and the company will be in debit if claims are higher than contributions (Al-Salih, 2014).

When we look to the practice in life we find there are two types of company's Takaful (Islamic insurance) and conventional insurance. Despite of the people always receive their services from not only Islamic insurance. It seems possible that these results are due to:

1- The difference between conventional insurance is not clear for everyone because there are some similarities in the first goal of insurance either Islamic insurance or Takaful insurance. In the shape and they do not have any knowledge about how they operate the fund risks and the nature of contracts and the rights and duties of insurer company and insured.
2- Conventional insurance companies still work and have a good quality and have experience of how to operate the insurance companies and calculate the risks. And because the conventional insurance companies have reliable in this industry. (Adel, Ruzeeg & Shukri, 2017)
3- There are different views of Shari'ah scholars in perspective Islamic. Despite most of scholars prohibited conventional insurance, but still a few scholars do not see the difference between them, and the

conventional insurance companies depend on their views. (Adel, Ruzeeg&Shukri, 2017) contrary, some current scholars and researchers' criteria Islamic models like wekalah or wekalah Mudarabah hybrid and others in some parts (salhi, unis, buhidah, 2013).

4- Islamic countries do not prevent the conventional insurance and these companies have a good confidence.
5- Most of scholars permissible of society insurance because it has not any pharar and only from one part which government (Sathi, 2010).

Conclusion:

Takaful is an alternative to conventional insurance. And the most important goal of insurance is to eliminate the risk or reduce it by sharing risks among society or groups, in order to protect society. Islamic incentive people to protect their self, religion, intellect, generation and wealth. Hence Shari'ah scholars attempt to find an alternative to conventional insurance. Because conventional insurance embedded some of the elements that are forbidden In Islamic rules. The scholars set up Takaful as an alternative so there are some similarities in the goals and types of insurance with conventional insurance. Whereas, there is a large difference in nature of contracts and in the way of operating fund risk that will not be clear for public population. Therefore the people claim there are no differences between them and there are some scholars claim that too. The important two differences are one, Risk sharing and risk transfer. In Takaful the participants risk shared risks among them. And the participants are the owner of fund risk, whereas in conventional insurance the risk was transferred to the company. Because the insured, sell the risk to insurance companies. hence the fund risk has owned by the shareholder of the insurer and the participant have not any equity in the insurer companies. The second is discipline and ethical rules. In Takaful all transactions comply Shari'ah rules, whereas in conventional insurance no any restrict for operating activities. In addition This paper mention causes let the scholars forbidden conventional insurance that because it contains elements of Reba and gharar and gambling or maysir.

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