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Takaful Business Models: A Review, a Comparison

Ahmad Tisman Pasha[1] and Mher Mushtaq Hussain[2]

Abstract
As an alternate to the general insurance, the Islamic insurance (Takaful) system is based on some rules and regulation. These rules and regulations define the criteria to collect the funds from the participants and invest these funds into investment avenues permissible under Shariah. Presently, several Takaful models have been evolved over time to satisfy the Shariah compliant and needs of the customers. The present article is basically a review article that explains and reviews different Takaful business models, after exploring the available literature. The article focuses on four Takaful business models and they are the Mudaraba, Wakala, Ta'awun and Wakal-Waqf models. Moreover, a brief comparison of these models has also been provided.

Key words: Bank Aljazira (BAJ) Takaful model (Ta'awun model); Mudarabah; Tabarru; Wakala Model; Wakala-Waqf model.

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INTRODUCTION

In this world, risk exists in every course of life and every one remains interested to minimize it. This situation gives a wide room to the idea of insurance that is a contract to minimize the risk of loss as a result of some unfortunate situation. Pfeffer (1956) defines as "insurance is a device for the reduction of risk of one party, called the insured, through the transfer of particular risks to another party, called the insurer, who offers a restoration, at least in part, of economic losses suffered by the insured" (see also Johnson, 1983 and Jorion and Khoury, 1995, for more details).

However, the acceptance of insurance, according to Islamic law or Shariah, is debatable (Ali, 1989, 2006; Billah, 1993, 1996; Bt. Esman, 2008; El-Gamal, 2000 and Mankabady, 1989 etc.). An alternative to the conventional insurance, there is idea of the Islamic insurance, "*Takaful*". The word "*Takfual*" originates from the Arabic word "*Kafala*", means "guarantee". *Takaful* therefore is the practice whereby individuals in the community jointly guarantee themselves against loss or damage (see the publications of Securities and Exchange Commission of Pakistan (SECP), and Ayub, 2003 for more details). To bring equity to all parties involved is the core objective of *Takaful* rather profit earning. However, sharing any profits generated incidentally is acceptable (Maysami and Kwon, 1999). In *Takaful*, the elements of *riba* (interest), *maisir* (gambling) and *gharar* (uncertainty) are removed from the operations. Further history and detail about *Takaful* can be seen in Obaidullah (2005) and *Takaful* Act 1984 of Bank Negara, Malaysia as cited in Akhter (2009), Klingmuller (1969), Maysami et al. (1997), Mahmood (1991) and Hussain and Pasha (2011), among many others.

The literature on Takaful emphasizes on its idea and its dissimilarity with the conventional insurance (e.g., see Ali 1989; Aris, 2004; Annuar et al., 2005; Ashraf, 2008; Billah 2003a,b; Ghifari , 2003; Maysami and Kwon 1999 and Shahzad, 2009etc.). Recently, Hussain and Pasha (2011) have provided the conceptual and operational dissimilarities between the Takaful and conventional insurance. Due to the popularity of the Takaful business model during the last decade, the researchers in this area have been attracted toward the comparison of different Takaful business models. Some literature is available in this aspect, including Ali (2006), Siddiqi (2000), Vardit (1985), Wahab (2006a,b) and Wahab et al. (2007) etc. However, the available literature, generally, does not address the comparison of different Takaful business models and this fact motivates us for the present article.

TAKAFUL BUSINESS MODELS

The main purpose of the Takaful business is not to generate the profit but in real world the business is run on the way of profit earning organizations. Presently, several Takaful models have

[1] *Department of Information Technology, Institute of Computing, Bahauddin Zakariya University Multan, Pakistan.*
E-mail: atisman120@hotmail.com
[2] *PhD Scholar (IMS) . Bahauddin Zakariya University Multan, Pakistan.*
E-mail: mherajiz79@gmail.com

been evolved over time not only to make the Takaful business Shariah compliant but also to satisfy the needs of the customers. This section introduces these models, describes their structure and elaborates their distinctive features.

The Mudaraba Model

The mudaraba is a kind of partnership in which one party that affords supplies funds while the other offers its expertise and management. It is based on classic profit sharing principles, i.e. a partnership in which two parties involved: one is fund provider which is called the *participant*, while the other person or party is called the *operator* who provides expertise and management of the fund. Both share the profits of the joint venture with a pre-defined ratio (see Akhtar, 2010; Bhatty, 2007; Hussain, 2010; Nadeem, 2010 and Wahab (2006a) for more details). Fig. 1 displays this model.

The Model Structure

A separate fund is created with the name of *General Takaful Fund* for the purpose of investment. Similar to the conventional insurance, a contract details are made that how the surplus and investment profits are shared between operator and participants. This model is based on profit-loss sharing between the takaful operator and the policy holders. The operator runs all the activities and operation in return for a share of the surplus on underwriting and a share of profit from investment.

Initial investment

Under mudaraba model, the initial investment is provided by the *rab-ul-mall* (participants/ policyholders) as *tabarru* (donation) to mutually help the participants who face an unfortunate situation. The takaful operator or *mudarib* does not provide any investment but manage the operation of takaful company.

Operational Cost of the Business

The participants are responsible to meet all management related expenses from their share and any remaining amount would be the participants' profits. However, if there is a deficiency in the takaful risk fund, then the Shariah advisory board and government regulatory body bound the takaful operator to provide interest-free loan.

Profit Distribution

The contract specifies how the surplus from the takaful operations is to be shared between the takaful operator and the participants. Under this type of contract, surplus is just like net income of the business which is generated by investing participant amount in *halal* business through creating a separate fund like *General Takaful Fund* or *Participant Investment Account* (PIA). The surplus is shared between *rabul-mall* and *mudarib* on predefined basis. Moreover, *mudarib* gets income by taking service charges to the business or participants.

What about Losses?

The *mudarib* does not share losses. All losses are covered by participants' contribution and investment income which is used to pay for claims from the General Takaful Fund. If funds are not sufficient to meet the deficit *Qard Hasnah* is provided by the participants.

Observations on the Mudaraba Model

The Shariah scholars agree with the conceptual basis related to the Mudaraba Model, but they have expressed some concerns which are discussed as under:

1. The Shariah scholars have an observation that the "Profit Sharing" contract should not be applied in this model and donation cannot become Mudaraba Capital at the same time (Wahab, 2006a).

2. In a Mudaraba contract, the question of distribution of profit is under observation. In this model, the earned profit is to be distributed while the profit is not the same as Surplus and in the insurance context no profit can be generated by definition Wahab, 2006a).

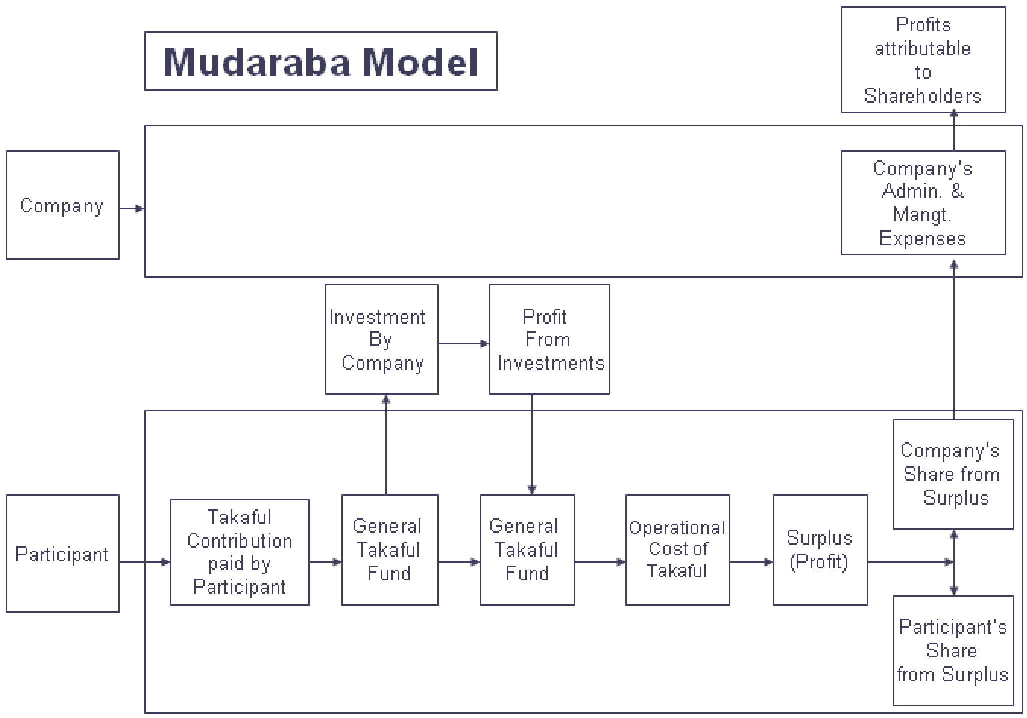
3. The sharing in underwriting surplus makes the contract essentially the same as conventional insurance contracts where the shareholders become "Risk Takers" and bear

the risk and return from the underwriting results just as any ordinary business venture not on the basis of mudaraba (Mahmood, 1991).

4. The requirement to provide *Qard-e-Hasnah* (in case of a deficit) is against the concept of Mudaraba which is a profit sharing contract and a Mudarib cannot be a guarantor at the same time (Laldin, 2008).

5. It is understood that the application of the Mudaraba approach to risk sharing does not seem to be correct and most of the new operators are applying the *wakala* based model or hybrids of *wakala* and mudaraba (Hussels et al., 2007).

Figure 1: The Mudaraba Model



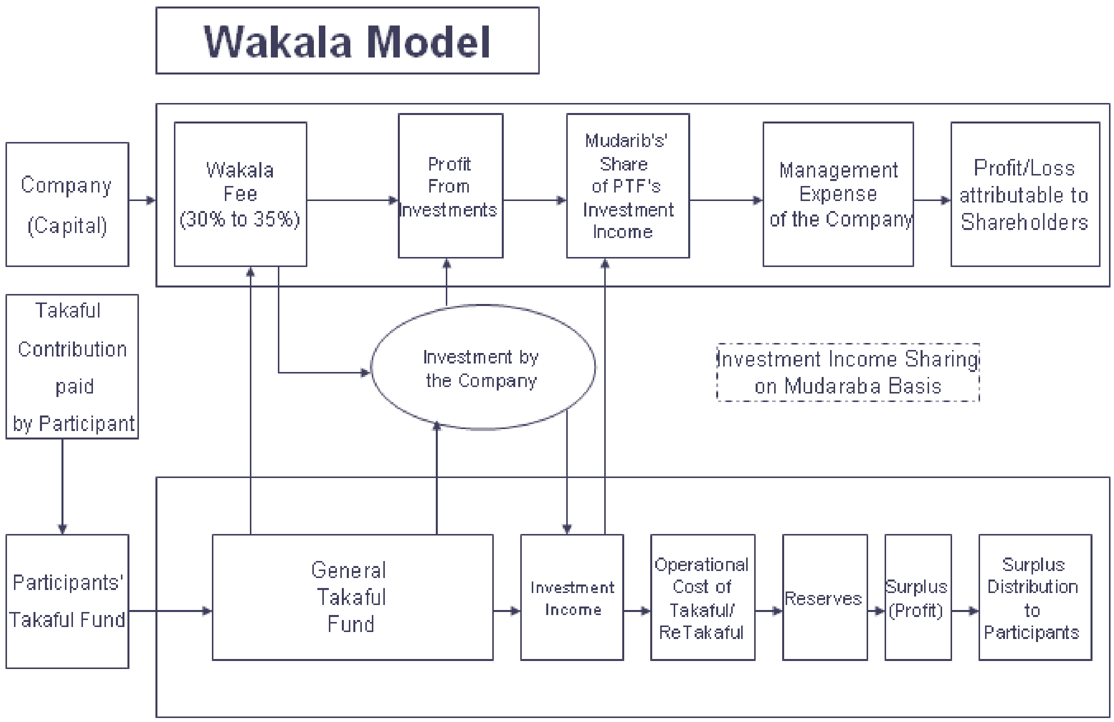
Source: Wahab(2006a)

The Wakala Model
Al wakalah is a term built on the root word '*wakalah*'. The word '*wakalah*' appears in the *Quran* in several times and bears several meanings, but in spite of that, they are all used to indicate "a representation of a person on behalf of another person in certain dispositions" (Napiah, 1995). Under this model, the operator charges a fee for fund management and performance. This fee is determined by the Shariah advisory board of the company.
The Wakala model is basically used to distinguish between the operating company (wakeel) and the takaful fund. Cooperative risk sharing occurs among participants where a takaful operator earns a fee for his/her services (as an agent) and does not participate or share in any underwriting results as these belong to participants as surplus or deficit (see Akhtar, 2010; Bhatty, 2007 and Wahab, 2006a for more details). Fig. 2 illustrates this model.
The Model Structure
Under this model, the takaful operator provides services on remuneration basis which is pre-agreed and there is no share in profit of the business. The net contribution after deduction of the operator fee is put into Participants' Risk Account (PRA) which is used to pay the claims, re-takaful and reserves adjustments purpose (Ayub, 2003).

Initial investment

Just like in the mudaraba model, in the wakala model, capital or initial investment is provided by the participants. During the contract period, if company faces a deficit due to adverse claims experience, the operator is usually obliged to make up for the deficit and provide so called Qard Hasnah or interest free loan which will be repaid , out of arising future surplus.

Figure 2: The Wakala Model



Source: Wahab(2006a)

Operational Cost of the Business

Many skills are required to successfully manage a wakala operation. The participants are responsible to meet all management related expenses from their share and any remaining amount to be the participant's profit.

Profit Distribution

Under Mudaraba profit is distributed between both parties i.e. participant and operator. But under Wakala operators provide its services as an agent on fixed fee or ratio base, so the total profit is distributed among the participants according to their contribution after paying all claims.

What about Losses?

Generally, a portion of the surplus may be retained as a contingency reserve and the balance may be distributed to participants in proportion to their contributions. The participant is responsible for all management and marketing costs. If company faces a deficit, the operator is usually obliged to make up for the deficit and provide extra funds (Qard-e-Hasnah).

Observations on the Wakala Model

The concerns related to *mudaraba* model, discussed above are resolved under a *wakala* model. However, some of the concerns related to the *wakala* model are as under:

1. Under a wakala model, the *tabarru* (donation) remains as the property of the participant, he/she has the right to receive the surplus back, and therefore it becomes conditional. It means that amount which is provided by participant is not donation as per *tabarru* definition (Wahab, 2006a).
2. The issue which is still being deliberated related to percentage share of the underwriting surplus which is paid as a performance incentive for the operator (Frenz, 2007).

3. As a wakeel, the operator is responsible for the fair management of the takaful fund.

The Bank Aljazira (BAJ) Takaful Model (Ta'awun Model)

This model is based on the concept of *Ta'awun* (mutual assistance). Under this system, members of the society mutually and voluntarily agree to contribute money to support a common goal of providing mutual financial aid to the members of the group in case of specific need. This is based on mutual protection and solidarity (Jaffer, 2007). Also see Akhtar (2010) and Wahab (2006a) for more details.

The Model Structure

This model works on mutual cooperation basis to guarantee mutual protection of the members. It is a response to what Allah wants Muslims to do on a cooperative basis to achieve the Ummah's interest. It transfers the social obligation of the community towards the financial assistance.

Initial Investment

Initial investment is provided by the participants or policy holders in Bank Aljazira model on the basis of mutual cooperation.

Operational Cost of the Business

In this model, all the participants entering into a contract voluntarily give consent in the form of absolute authority to the Bank Aljazira to run the business. The Bank Aljazira acts as trustee and receives fixed charges in the shape of agency fee.

Profit Distribution

Under this model, if the company earns a profit after paying all their claims and creating special reserves for fulfilling future need, the major share of remaining surplus is distributed among the participants.

What about Losses?

If the company makes a deficit in any specific duration, the deficit is paid from the participant's individual investment account (PIA), if the amount is not sufficient to meet the deficit then the participants provide the amount as *tabarru* in the year of deficit occurrence.

The Wakala-Waqf Model

This model has been implemented by takaful companies working in Pakistan and some other countries. This model was developed by an *Ijmah* meeting of over 40 Shariah scholars organized by Darul Uloom, Karachi. The *Ijmah* gathering debated on the mudaraba and wakala models and pointed out some matter about these models. Finally, after these debates, a refinement of the wakala model evolved, based on the concept of a separate entity of Waqf fund (Wahab, 2006a,b). Waqf fund is a well recognized Shariah entity which has been in existence since the days of the Holy Prophet (SAWW). The waqf rules do exist in most of the Muslim countries. Fig. 3 explains this model.

The Model Structure

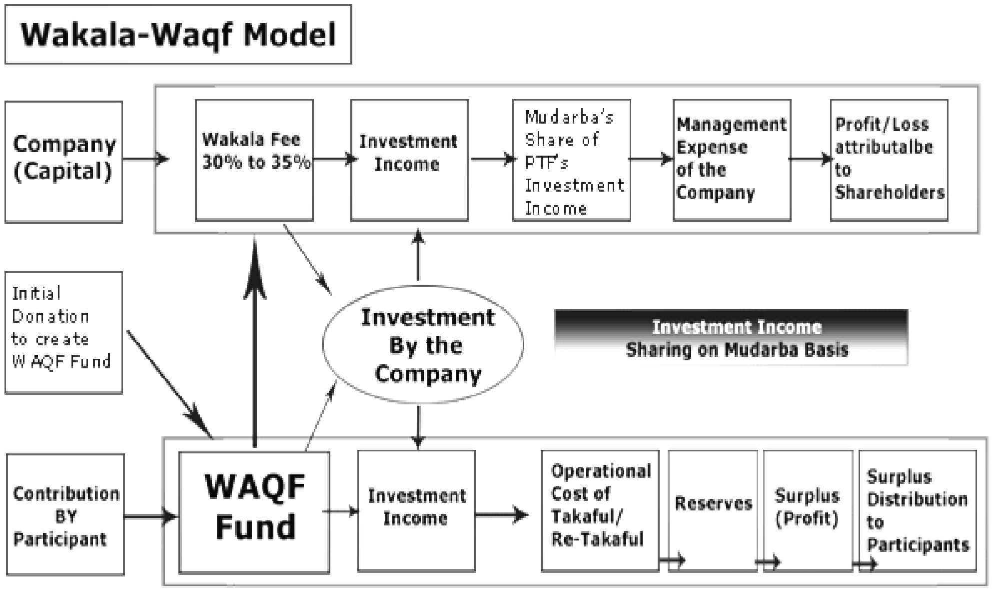
The purpose of waqf model is to set up a separate Shariah entity which has the ability to accept ownership. If there are no legal issues, the waqf entity is required to be registered. The purpose of the waqf fund is to provide relief to participants against losses (Wahab, 2006).

In a typical wakala contract, the *tabarru* or *hiba* is not complete as it is conditional on being used to pay claims and there is an element of surplus which may come back to the participants. From a Shariah perspective proportionate ownership of the funds not utilized for claim settlement remains to the participants (Billah, 1997).

Initial Investment/Donation

The shareholders initially make a donation to establish the Waqf fund. The donation can be any reasonable amount which is specified by the shariah scholars. After creation of the Waqf fund, the shareholders lose their ownership rights on the Waqf fund. However, they have the right to administer and develop rules and regulations of the fund. The original donation of the Waqf fund is invested in a very safe shariah compliant investment and its return is used for the benefit of the participants. Moreover, different line of Takaful services, more than one Waqf fund can be formed with the shareholders money (Mughal 2008).

Figure 3: The Wakala-Waqf Model



Source: Wahab(2006a)

Operational Cost of the Business/Donation

The operational cost of business is met through the fund which is collected from participant. The fund is used for claim settlement and as well as for investment purpose. The profit earned on investment is again deposited to the investment fund. The company utilizes the fund on the basis of Waqf fund. The amount of donations for creation of fund is determined on the basis of risk.

Profit Distribution

This model is a mixture of mudaraba and wakala model and the surplus is distributed among the participants and operators on some predefined basis. The operator gains dual benefit on one hand charges fixed fee on wakala base and on the other hand also gets the share of profit on mudaraba base. So the operator has more privilege and benefits as compared to the other Takaful model.

What about Losses?

The waqf fund rules are defined for the compensation of losses and sharing of surplus to its members but there is no obligation to distribute surplus. Additionally, all the operational costs are also required to meet from the same fund.

CONCLUSION

The Takaful system is still being evolved with a number of observations, made by different shariah scholars. It is therefore, necessary to encourage this evolution by debates, discussions and alternative approaches. In this way, ultimately, a uniform consensus based system can be introduced.

The shariah concerns, relating to the Wakala model are addressed by setting a separate Waqf entity in between the participants and the company, without disturbing the basic model.

Finally, following Table 1 summarizes the similarities and differences among the above discussed models.

Table 1: Similarities and Difference among the Takaful Models

Characteristics	Mudaraba	Wakala	Ta'awun	Wakala Waqf
Surplus/ Profit	Profit sharing b/w the participant and operator	Surplus repaid to the participant.	Surplus repaid to the participant.	Surplus is paid to the participant. However, some minor share is to be given to the operator.
Operator Income	Profit sharing by the company	Fixed amount as fee income	Agency charges	Fee income plus share in profit
Profitability of the company	The company profit depends on the investment in halal business	The company profit depends on remaining amount after paying fee	The Organization mainly focuses on mutual assistance and cooperation	Waqf fund for paying claim and mudaraba for profit sharing
Tabarru	Premium paid for takaful cover and profit share.	Subscription represents donation.	Subscription represents donation.	Main focus on Qard Hasnah
Time Duration	Invested for longer time period	Shorter time period	Longer time period	Shorter time period
Application	Suited for both general takaful and family takaful.	Suitable for general takaful	Mainly focuses on family takaful	Both for family and general takaful.
Operator Role	As a shareholder	As a wakeel	As an agent	As a wakeel and shareholder.

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