

**OPERATION OF ISLAMIC INSURANCE IN SRI LANKA:
DEVELOPMENTS AND CHALLENGES**

SEYED MOHAMED MOHAMED MAZAHIR

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ABSTRACT

Takāful (an alternate insurance under Islamic law) is a rapid developing industry in the world as well as in Sri Lanka, an Asian Muslim minority country. At present, a large number of insurance customers prefer Takāful insurance to other conventional insurance. For attracting these customers, the conventional insurance operators initiated a wing of Islamic insurance in their companies. This situation has posed a scientific research to evaluate the current state of Takāful industry in Sri Lanka and its developments and challenges. This study was planned to address this gap.

The objectives of this study were to assess the operation of Takāful in Sri Lanka, to evaluate Takāful developments in terms of jurisprudential and business developments, to identify the challenges faced by Takāful industry in Sri Lanka and to propose solutions to the identified challenges and to strengthen Takāful insurance in Sri Lanka

In this study, the investigator adopted survey method. He collected data for the study by using the tools of focus group interviews and the content analysis from the Secondary data.

The sample for the study was selected from among the Takāful operators including members of the *Sharī'ah* advisory council (12 persons), *Sharī'ah* scholars including intellectuals (10 persons) and Takāful customers (20 persons). The investigator used purposive sampling technique to select the sample.

The data obtained from the interviewees and from the secondary data were analyzed by using the method of descriptive analysis and transformed into chapters of the thesis. The findings are categorized mainly on three titles as assessment of current state of Takāful in Sri Lanka, its developments and the challenges respectively.

Based on the findings of the study, the investigator suggested a number of constructive suggestions for Takāful operators, *Sharī'ah* advisors, educators, intellectuals and participants.

This thesis contributes to the field of research in the subject of Takāful generally and to Takāful industry in Sri Lanka particularly. It opens a window to new researchers to do in-depth research on number of issues consisted in this thesis.

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ABSTRAK

Takaful (insurans alternatif di bawah undang-undang Islam) merupakan industri yang sedang pesat membangun di dunia, termasuk di Sri Lanka, sebuah negara minoriti Muslim di Asia. Pada masa ini, sebilangan besar pelanggan insurans lebih cenderung kepada takaful berbanding insurans konvensional yang lain. Demi menarik minat pelanggan ini, pengendali insurans konvensional memperkenalkan cabang insurans berasaskan Islam di syarikat mereka. Keadaan ini menyebabkan perlunya kajian saintifik untuk menilai keadaan semasa industri takaful di Sri Lanka, perkembangan serta cabarannya. Kajian ini bertujuan untuk menangani jurang ini.

Objektif kajian ini adalah untuk menilai operasi takaful di Sri Lanka, menilai perkembangan takaful dari segi fiqh dan pembangunan perniagaan, mengenal pasti cabaran yang dihadapi oleh industri takaful, mencadangkan jalan penyelesaian dan mengukuhkan insurans takaful di Sri Lanka.

Dalam kajian ini, penyelidik menggunakan kaedah tinjauan. Beliau mengumpul data melalui temu bual kumpulan sasaran dan analisis kandungan daripada data sekunder.

Sampel kajian telah dipilih daripada kalangan pengendali takaful termasuk ahli-ahli majlis penasihat Syariah (12 orang), ulama dan cendekiawan Syariah (10 orang) serta pelanggan takaful (20 orang). Penyelidik menggunakan teknik persampelan tujuan untuk memilih sampel.

Data yang diperolehi daripada mereka yang ditemu bual dan data sekunder telah dianalisis menggunakan kaedah analisis deskriptif dan digubah menjadi bab tesis ini. Dapatan kajian telah dikategorikan kepada tiga bahagian, iaitu penilaian keadaan semasa takaful di Sri Lanka, perkembangan dan cabarannya.

Berdasarkan dapatan tersebut, penyelidik mencadangkan beberapa usul membina bagi pengendali takaful, penasihat Syariah, pendidik, cendekiawan dan peserta.

Tesis ini diharap dapat menyumbang kepada bidang penyelidikan takaful secara amnya dan industri Takaful di Sri Lanka secara khususnya. Ia membuka peluang kepada para penyelidik baru untuk melakukan kajian secara mendalam terhadap beberapa isu yang timbul di dalam tesis ini.

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DEDICATION

This thesis is dedicated to my loving father, *Marhūm* NM. Seyed Mohamed for his love, courage, guidance and sacrifice. It is also dedicated to *Marhūm Al Haj* MIM. Naleem for setting a strong base to educate me and Sri Lankan Muslims institutionally in the sphere of *Sharī'ah* and formal education.

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In the name of Allah, the most Gracious, the most Merciful.

All praises to the Almighty Allah (SWT) and may eternal peace and His blessings be upon our beloved Prophet Muhammad (PBUH), his family, and his companions.

First and foremost, I would like to thank and praise Allah (SWT) for His blessing on me to have allowed me the opportunity to complete my doctoral research. Without His blessing and mercy, my thesis would not have seen the light of day.

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My whole-hearted thanks go to my beloved mother Safa (Razeena) Umma, my wife Nifaza, my children Nuha, Muna and Almas, my brothers, my sisters and my friends who were a great source of encouragement and support. Their moral and mental support to continue to my PhD will never be forgotten.

Last but not least, my thanks and appreciation go to all those who contributed towards the completion of this study. May Allah bless and repay their assistance and bestow His blessings on all of them.

Syed Mohamed Mohamed Mazahir,
South Eastern University of Sri Lanka,
Olivil # 32360,
Sri Lanka.

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LIST OF ABBREVIATIONS

AAOIFI	– The Accounting and Auditing Organization for Islamic Financial Institutions
ACJU	- All Ceylon <i>Jam'iyathul 'Ulama</i>
ACR	– Asian Capital Reinsurance
AIG	- American Insurance Group
APEC	– Asian-Pacific Economic Cooperation
ASEAN	– The Association of Southeast Asian Nations
ATL	- Amana Takāful PLC
AUB	– <i>Ahli</i> United Bank
BC	– Before Christ
BIS	– Bank of International Settlements
BMA	– Bahrain Monetary Agency
BoC	– Bank of Ceylon
BoD	- Board of Directors
C	– Celsius
CAGR	– The Compound Annual Growth Rate
CBB	– Central Bank of Bahrain
CBSL	– Central Bank of Sri Lanka
C.E.	- Common Era or Current Era
CEO	– Chief Executive Officer
CSE	- Colombo Stock Exchange
CSR	– Corporate Social Responsibility
CTIL	- Ceylinco Takāful Ltd.
DBG	– Dubai Banking Group
ECFR	– European Council for Fatwa and Research
F	– Fahrenheit
FDI	– Foreign Direct Investment
FTA	– Free Trade Agreement
GATT	– General Agreement on Tariffs and Trade

GCC – Gulf Cooperation Council
 GDP – The Gross Domestic Product
 HNB – Hatton National Bank
 IAIS – International Association of Insurance Supervisors
 IASL - Insurance Association of Sri Lanka
 IBSL – Insurance Board of Sri Lanka
 ICP – Insurance Code Principle
 IDB – Islamic Development Bank
 IFI – Islamic Financial Institution
 IFRS – International Financial Reporting Standard
 IFSA – Islamic Financial Service Act
 IFSB - Islamic Financial Standards Board
 IFSI - Islamic Financial Services Industry
 IIFS - Institutions offering Islamic Financial Services
 IIIT - International Institute for Islamic Thought
 IMF – International Monetary Fund
 IRIC - Inter Regulatory Institutions Council
 LLRC – Lessons Learnt and Reconciliation Commission
 LTTE – Liberation Tigers of Tamil *Eelam*
 MAS – Monetary Authorities of Singapore
 MASB – Malaysian Accounting Standards Board
 MLA – Monetary Law Act
 MSC - The Malaysian Securities Commission
 MYR – Malaysian Ringgit
 NAM – Non-Aligned Movement
 NBFi – Non-Bank Financial Institutions
 NCB – No Claim Bonus
 NCD – No Claim Discount
 NCRS - National Council for Road Safety
 NHN - National Highway Network

NITF – National Insurance Trust Fund
 OIC – Organization of Islamic Conference
 PA – Participants’ Account
 PBUH – Peace be Upon Him
 PIF – Participants’ Investment Fund
 PRF – Participants’ Risk Fund
 PSA – Participants’ Special Account
 RII – Regulation of Insurance Industry
 SAARC – The South Asian Association for Regional Cooperation
 SAC – *Sharī’ah* Advisory Council
 SAMA - Saudi Arabia Monetary Authority
 S.A.W. – *Ṣallallāhu ‘Alaihi wa Sallam*
 SECP - Securities and Exchange Commission of Pakistan
 SHF – Shareholders’ Fund
 SIRCL - *Shiekan* Insurance and Reinsurance Company
 SLFP – Sri Lanka Freedom Party
 SLIBA - Sri Lanka Insurance Brokers’ Association
 SLII - Sri Lanka Insurance Institute
 SSB - *Sharī’ah* Supervisory Board
 SSC - Sinhalese Sports Club
 SWT – *Subḥānahu Wata’āla*
 UF – United Front
 UN – United Nations
 UNP – United National Party
 UPFA – United People’s Freedom Alliance
 USA – United States of America
 USD/\$ - United States Dollar
 UWL - Underwriting Loss
 UWS - Underwriting Surplus
 WTO – World Trade Organization

ARABIC TRANSLITERATION¹

1. Consonant

ء, ا	a, ‘ (Hamzah)	ط	ṭ
ب	b	ظ	ẓ
ت	t	ع	‘
ث	th	غ	gh
ج	j	ف	f
ح	ḥ	ق	q
خ	kh	ك	k
د	d	ل	l
ذ	dh	م	m
ر	r	ن	n
ز	z	ه	h
س	s	و	w
ش	sh	ي	y
ص	ṣ	ة	h
ض	ḍ		

2. Vowels

Short Vowel	Transliteration	Example	Transliteration
--َ (fathah)	a	قَاتَتْ	qanata
--ِ (kasrah)	i	سَلِمَ	salima
--ُ (Dommah)	u	جُعِلَ	ju’ila

Long Vowel	Transliteration	Example	Transliteration
ا/ى	ā	بَابُ / كُبْرَى	bāb / kubrā
ي	ī	وَكَيْلٌ	wakīl
و	ū	سُورَةٌ	sūrah

¹ Transliteration method in this study referred to the Akademi Pengajian Islam Universiti Malaya thesis guidance book. See Akademi Pengajian Islam, Buku Panduan Penulisan Tesis/Disertasi, Akademi Pengajian Islam, Universiti Malaya, Kuala Lumpur: Penerbit Universiti Malaya, pp. 25-31

3. Diphthongs

Diphthong	Transliteration	Example	Transliteration
اَوْ	aw	قَوْلٌ	qawl
اَيٌّ	ay	خَيْرٌ	khayr
اُوٌّ	uww	قُوَّةٌ	quwwah
اِيٌّ	iy / i	عَرَبِيٌّ	'arabiy/i

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CHAPTER 1: INTRODUCTION OF THE STUDY

1.1 Background and Overview

The history of insurance can be traced to human endeavours of self-help. Over time, this mechanism of helping and sharing evolved into the system of insurance we know today.

As Dorfman¹ described, insurance is a financial arrangement which redistributes the costs of unexpected losses. It is a risk transferring arrangement between two parties. It is also an economic device in which individuals and organisations can transfer pure risks to others. In other words, it is an arrangement where the “unwanted” risks may be transferred to others for a fee or a premium.

Adversity and misfortune are common occurrences in most human endeavours, they are natural and inevitable and human history is replete with events of misfortune. This phenomenon was exacerbated as society evolved from agrarian to modern industrial. The onset of industrialisation exponentially increased the incidence of the risk of loss and brought about the urgent need to devise mechanisms to mitigate the risk of financial loss.

Developments in the transport sector and the increased use of technology in industry increased the frequency of risk, and to mitigate the repercussions of these unexpected hazards and to cover the chances of loss, insurance evolved as an essential service to modern life, consequently influencing almost all areas of human activity.

¹Dorfman, M.S. (1978). Introduction to Insurance, Inc. Englewood Cliffs: Prentice-Hall, p. 3

Several important legal and socioeconomic institutions that developed in the west during the last four hundred years have left a strong impact on the affairs of Muslim society. These institutional practices have also conflicted with Islamic values and principles. As a result, Muslim scholars and economists have become more conscious of this conflict and stressed the need for developing alternatives to Muslim society.

To achieve this purpose, it was not only necessary for Muslim scholars to have an in-depth knowledge of the principles and practice of contemporary finance, they also needed a strong understanding of the laws of Islam to develop alternatives to the socioeconomic system and meet the needs of Muslims without violating fundamental Islamic principles. One such alternative measure developed by Muslim scholars to the practice of insurance is *Takāful*. In formulating *Takāful*, these scholars carefully examined theories and practices in conventional economics and finance and used Islamic laws and values as enshrined in the *Al-Qur'an* and the *Al-Hadīth* to formulate alternative approaches.

In this backdrop, Muslim countries managed to replace conventional insurance with *Sharī'ah* compliant insurance. According to Taylor², *Takāful* is a relatively new industry. Although *Takāful* can be traced to Islamic practices 14 centuries ago, its development in modern times was initially undertaken in Sudan in 1979 and Malaysia in 1984.

Sharī'ah compliant insurance is now readily accessible to Muslims. There are over 250 such *Takāful* companies globally. Saudi Arabia and Malaysia are the leaders in

² Taylor, D.Y. (2005). *Takāful* in the new millennium, ICMIF *Takāful* Article, No:1, p.1

Islamic insurance. Ernst & Young³ reported in a news release that Saudi Arabia remains by far the largest Takāful market contributing US\$6.8 billion or 48% of the industry. Malaysia grew 23% to reach contributions of US\$3.3 billion. The third ranking is held by the UAE with contributions of US\$1.3 billion, growing at 9.4%. Overall, global gross Takāful contribution is estimated to reach US\$ 14 billion in 2014 from an estimated US\$ 12.3 billion in 2013. ASEAN countries (Malaysia, Indonesia, Brunei, Singapore, and Thailand), driven by strong economic dynamics and young demographics, continue to achieve buoyant growth at 22% compound annual growth rate (CAGR). Year-on-year growth has moderated from a high CAGR of 22% (2007-11) to a still healthy growth rate of 14% over 2012-14.

As far as the Muslim minority of Sri Lanka is concerned, significant efforts have been undertaken by pioneering visionaries to introduce the Islamic insurance (Takāful) system. However, at present there is only one stand-alone Takāful company (Amana Takāful PLC) which provides Islamic insurance services that is legally registered under Regulation of Insurance Industry Act No. 43 of 2000 (As amended). There are however other Takāful initiatives, not as stand-alone and fully fledged, but operating as separate divisions of conventional insurance companies offering Takāful services. Another stand-alone Takāful company, namely Ceylinco Takāful Ltd. began operations but had to cease all activity as it was prohibited from engaging in insurance since 5 August 2009 by the Sri Lanka Insurance Board. Hatton National Bank (HNB) Assurance also started 'HNB Assurance Takāful' as a window operation in July 2013. Takāful in Sri Lanka has now developed into a clinically precise operating system after facing many challenges and

³ Ernst & Young (2014). Global *Takāful* Insights, p.7

issues. This situation warrants a study to assess the present state of Takāful in Sri Lanka and to examine its developments and challenges.

1.2 Statement of the Problem

The Muslim world has witnessed changes in ideologies related to banking and Takāful under the influence of secularism and materialism. Conventional insurance practices have penetrated into all aspects of life of the Muslim community. This has led to changes in the social, political, and economic patterns of many Muslims adopting conventional insurance as a perfectly acceptable form of risk management. However Muslim jurists have unequivocally and consistently rejected conventional insurance as unacceptable and inconsistent with *Sharī'ah*. These jurists urged the formulation of an alternative *Sharī'ah* compliant insurance system. The alternative Takāful system took root in Sri Lanka since 1999.

Takāful in Sri Lanka is licensed by the Insurance Board and is regulated by the same legislative enactments governing conventional insurance. In the absence of a specific regulatory establishment for Takāful, insurance as practiced here needs to be researched and assessed in the light of developments and challenges faced by Takāful in Sri Lanka, even after a decade of its operation. It is in this context that the present study is planned.

1.3 The Research Questions

1. What is the present state of Islamic insurance in Sri Lanka?
2. How far has Takāful developed in Sri Lanka?

3. What are the challenges facing the Takāful industry?
4. What are the options available to overcome the challenges?

1.4 Scope of the Study

The study is restricted to two perspectives of development of the Takāful industry in Sri Lanka, namely jurisprudential developments and business developments covering 11 components of the development process: growth, products, investments, participants, staff, branches, retakāful, bancatakāful, education, training and research, CSR programmes and Takāful window.

The sample comprises 42 people made of Takāful operators with members of the *Sharī'ah* advisory council, *Sharī'ah* scholars and intellectuals, and Takāful customers.

1.5 Objectives of the Study

The objectives of the study are: -

1. To assess the present state of Islamic insurance in Sri Lanka.
2. To assess developments of Islamic insurance in Sri Lanka.
3. To identify challenges faced by the Takāful industry in Sri Lanka.
4. To propose solutions to these challenges and to strengthen Takāful in Sri Lanka.

1.6 Significance of the Research

The Takāful industry in Sri Lanka is in its initial state of development compared to the conventional insurance system. Conventional insurance companies have more than 50 years of experience and are capitalised with strong cash flows. They also enjoy substantial insurance portfolios with sizable savings and investments and a wide offering of attractive insurance plans. The Takāful industry by comparison is still small with limited resources and customers. Customers are therefore attracted to conventional insurance companies for their insurance needs. This has compelled the Takāful industry in Sri Lanka to compete with conventional insurance and introduce policies that attract as many customers as possible including the non-Muslim community.

Competition has intensified with many state and private banks opening Takāful windows to attract Muslim customers. HNB recently opened a Takāful window. Similarly, Bank of Ceylon (BoC) and People's Bank have plans to open Takāful windows to cash in on the growing Takāful market. The Sri Lankan government is considering proposals to allow overseas Takāful companies to expand their operations to Sri Lanka.

This situation poses challenges to the survival of the Takāful industry in Sri Lanka. To deal with this scenario, the Takāful industry needs to be proactive, creative, and aggressive in business. However, according to available evidence, there is little research or developmental planning in the field of Takāful in Sri Lanka to find solutions to these problems.

Given the context, this study "Operation of Islamic Insurance in Sri Lanka: Developments and Challenges" is both timely and relevant.

1.7 Methodology

This study was designed to assess the developments and the challenges of Takāful in Sri Lanka and to propose solutions to these challenges. The researcher followed systematic and scientific methods throughout the study for drawing conclusions.

This section offers a detailed account of how this study was conducted. It describes the method of study, population and sample, tools, procedures, and data analysis.

1.7.1 Method of the Study

This study adopted the sample survey method. Data were collected through focus group interviews and secondary data were subjected to content analysis. This study takes on the individuality of both the descriptive and causal research strategies, which were useful in helping meet the varied requirements of this research. The main requirements included descriptive research of this condition as well as a discussion of its causes. The descriptive research was used to describe the history, theories, characteristics and the scope of the problem, while the causal research determines which factors or variables influence the Islamic insurance system in Sri Lanka.

The study uses the qualitative approach to generate answers for what and why questions which cater to the research objectives. Qualitative research helps to interpret and understand the complex reality of the present situation and its implications on the Takāful system in Sri Lanka. Because this study requires peoples' views, understandings,

interpretations, experiences, and interactions, thus interviewing is the most suitable and relevant instrument to the designed research questions.

1.7.2 Population of the Study

The population of the study constitutes all the Takāful operators including members of the *Sharī'ah* advisory council, *Sharī'ah* scholars including intellectuals, and Takāful customers in Sri Lanka.

1.7.3 Sample of the Study

The sample of the study was selected from among the Takāful operators including members of *Sharī'ah* advisory council, *Sharī'ah* scholars including intellectuals, and Takāful customers in Sri Lanka. By using a carefully chosen sampling method, 12 Takāful operators including members of the *Sharī'ah* advisory council, 10 *Sharī'ah* scholars including intellectuals, and 20 Takāful customers were selected. Purposive sampling was used because the data were information rich.

Table 1.1: Group One - Takāful Operators with Members of *Sharī'ah* Advisory Council

No	Name, Designation and Company	Date, Duration and Place of Interview	Objectives Achieved	Language Used
1	Mr. M. Fazal Gaffoor Chief Executive Officer (CEO) Amana Takāful	19/8/2013 55.49 Minutes CEO Office, 98, Baudhaloka Mawatha, Colombo – 04	1-4	English
2	Mr. Zaid Aboobucker General Manager (operation and medical) Amana Takāful	19/8/2013 34.21 Minutes Head Office, 98, Baudhaloka Mawatha, Colombo – 04	1-4	Bilingual (English and Tamil)

Table 1.1 Continued:

No	Name, Designation and Company	Date, Duration and Place of Interview	Objectives Achieved	Language Used
3	Mr. NM. Ifthikar Regional Manager, Central Region Amana Takāful	7/8/2013 24.20 Minutes Interviewee's office, 105/2, Kotugodalla Street, Kandy	1-4	English
4	Mr. MMM. Ashik Branch Manager, Kurunegala branch Amana Takāful	26/8/2013 34.21 Minutes Interviewee's Office, 07, Circular Road, Kurunegala	1-4	English
5	Mr. SMM. Rahman Branch Manager (life), Kalmuai Branch Amana Takāful	11/7/2013 31.39 Minutes Interviewee's office, 32, Mallika Building, Main street, Kalmunai	1-4	Tamil
6	Mr. SAH. Mohideen Former General Manager and Chartered Insurer Ceylinco Takāful	22/8/2013 55.29 Minutes Interviewee's office at GM Life Insurance Corporation (Lanka) Ltd. Colombo	1-4	English
7	Mr. Hifly Huzair Manager, HNB Assurance Takāful	24/8/2013 25.55 Minutes Telephone Interview	1-4	Bilingual (English and Tamil)
8	Mr. AJM. Mahroof Sales Executive Amana Takāful	26/8/2013 30.55 Minutes Amana Takaful Office, Kurunegala	1-4	Bilingual (English and Tamil)
9	Mr. MMM. Mafahir <i>Takaful</i> Agent Amana Takāful	17/8/2013 41.32 Minutes Interviewee's Residence, L70/4A. Bulugohatenna, Akurana	1-4	Tamil
10	Mr. MMM. Rinas Junior Sales Executive Amana Takāful	17/8/2013 29.51 Minutes Interviewer's Residence, 211, Bulugoahatenna, Akurana	1-4	Tamil
11	<i>As Sheikh</i> MMA. Mubarak Chairman of <i>Sharī'ah</i> advisory council Amana Takāful	19/8/2013 42.44 Minutes Interviewee's office at All Ceylon Jamiyyathul Ulama, Maradana, Colombo – 10	1-4	Tamil

Table 1.1 Continued:

No	Name, Designation and Company	Date, Duration and Place of Interview	Objectives Achieved	Language Used
12	<i>As Sheikh</i> M. Murshid Mulaffar Secretary of <i>Sharī'ah</i> Advisory Council Amana Takāful	19/8/2013 32.24 Minutes Interviewee's office at Amana Takaful/Life, Boudhaloka Mawatha, Colombo	1-4	Bilingual (English and Tamil)

Table 1.2: Group Two - *Sharī'ah* Scholars and Intellectuals

No	Name, Designation, Institution/Compan/Society	Date, Duration of Interview and Place of Interview	Objectives Achieved	Language Used
1	<i>Moulavi</i> MHM. Burhan President (KDJU) and Vice-President (ACJU) Kandy district <i>Jam'iyatul 'Ulama</i> and All Ceylon <i>Jam'iyatul 'Ulama</i>	28/8/2013 32.23 Minutes Telephone Interview	2-4	Tamil
2	<i>As Sheikh</i> SH. Atham Bawa, President (ADJU) and Vice-President (ACJU) Ampara district <i>Jam'iyatul 'Ulama</i> and All Ceylon <i>Jam'iyatul 'Ulama</i>	28/8/2013 11.51 Minutes Telephone Interview	2-4	Tamil
3	<i>Moulavi</i> AS. Hibathullah, President, Telumbugalla Welfare Society, Kurunegala	28/8/2013 10.35 Minutes Telephone Interview	2-4	Tamil
4	<i>Usthath</i> MAM. Mansoor Director, <i>Mishkath</i> Institute for Islamic Research, Akurana,	16/8/2013 46.13 Minutes Interviewee's Residence, 99, Waragashinna, Akurana	2-4	Tamil

Table 1.2 Continued:

No	Name, Designation, Institution/Compan/Society	Date, Duration of Interview and Place of Interview	Objectives Achieved	Language Used
5	<i>As Sheikh</i> AM. Mihar Head of Social Welfare and Counselling, Zahira College, Colombo	20/8/2013 49.43 Minutes Zahira College, Colombo – 10	1-4	Bilingual (English and Tamil)
6	Dr. SMM. Nafees Senior Lecturer, Dept. of Islamic Studies South Eastern University of Sri Lanka, Oluvil	9/7/2013 16.49 Minutes South Eastern University of Sri Lanka	1-4	Bilingual (English and Tamil)
7	<i>As Sheikh</i> AWM. Imthiyaz Legal Advisor Amana Takāful	24/8/2013 28.51 Minutes Telephone Interview	2-4	Tamil
8	Mr. MBM. Muath Head of Finance and Corporate Strategy, First Global Group, Colombo	26/8/2013 24.49 Minutes KFC Restaurant, Peradeniya Road, Kandy	1-4	English
9	Mr. MA. Saleemudeen Chief Area Manager Finley Insurance Brokers (Pvt.) Ltd., Kandy	16/8/2013 11.34 Minutes Finley Insurance Brokers (Pvt.) Ltd., Kandy	2-4	Bilingual (English and Tamil)
10	Mr. SHM. Nizar Advisor of Insurance Sri Lanka Insurance Corporation	31/8/2013 45.47 Minutes Interviewee's home, 178/3, Dodangolla, Akurana	2-4	Tamil

Table 1.3: Group Three – Takāful Customers

No	Name, Profession/ Occupation and Company / Organisation / Firm	Date, Duration and Place of Interview	Objectives Achieved	Language Used
1	Mr. MHM. Nairoos Lecturer (prob.), Dept. of Islamic Studies South Eastern University, Oluvil	9/7/2013 16.02 Minutes South Eastern University, Oluvil	1-3	Tamil
2	As Sheikh ARM. Ashraf Teacher Central College, Sammanthurai	9/7/2013 15.24 Minutes Interviewee's Residence, Ibrahim Manzil, Block J East, Sammanthurai	1-3	Tamil
3	Mr. SM. Azwar Teacher in Guidance and Counselling Zonal Education Centre, Sammanthurai	9/7/2013 13.42 Minutes Interviewee's Residence, 51, Sinnap Palli Lane, Sammanthurai – 8	1-3	Tamil
4	Mr. Uvais Mohideen Bawa Program Manager MFCD Ampara Region	10/7/2013 15.08 Minutes Staff Quarters, South Eastern University of Sri Lanka, Oluvil	1-3	Tamil
5	Mr. AM. Farees Internal Auditor Assistant NWS & DB, Akkaraipattu	10/7/2013 26.14 Minutes Staff Quarters, South Eastern University of Sri Lanka, Oluvil	1-3	Tamil
6	Mr. MA. Sakaf Teacher, Al Manar Central College, Maruthamunai	31/8/2013 09.11 Minutes Telephone Interview	1-3	Tamil
7	Mr. MI. Ubaidur Rahman Handloom Producer Maruthamunai	31/8/2013 17.02 Minutes Telephone Interview	1-3	Tamil
8	Mr. SL. Badurdeen Proprietor SLB construction services, Maruthamunai	31/8/2013 15.23 Minutes Telephone Interview	1-3	Tamil

Table 1.3 Continued:

No	Name, Profession / Occupation and Company / Organisation / Firm	Date, Duration and Place of Interview	Objectives Achieved	Language Used
9	Mr. MBM. Fawaz Partner Mode Emporium, Kurunegala,	13/8/2013 13.13 Minutes Interviewer's Residence, 211, Bulugohatenna, Akurana	1-3	Tamil
10	Mr. MFM. Razlan Proprietor E-Mart Fashion, Akurana	16/8/2013 20.07 Minutes Interviewee's Shop, E- Mart Fashion, Dunuwila, Akurana	1-3	Tamil
11	Mr. MIA. Faiz Chairman Omega Steels (Pvt) Ltd., Anuradapura	17/8/2013 42.41 Minutes Interviewee's Residence, 261/1B, Hingurumudune Road, Akurana	1-3	Tamil
12	As Sheikh B. Tharik Ali Translator Dept. of National Botanic Gardens	14/8/2013 32.16 Minutes Interviewee's Residence, 78B, Kudugala	1-3	Tamil
13	Mr. SAM. Thasleem Partner Choice Park shopping Centre	25/8/2013 14.43 Minutes Interviewer's Residence, 211, Bulugohatenna, Akurana	1-3	Tamil
14	Mr. MZM. Riyas Director Milano bakers (Pvt.) Ltd. Akurana	25/8/2013 46.07 Minutes Interviewer's Residence, 211, Bulugohatenna, Akurana	1-3	Tamil
15	Mr. AMM. Mursaleen Proprietor New Ajmeer Stores, Kurunegala	26/8/2013 04.16 Minutes Interviewee's Shop, New Ajmeer Stores, Kurunegala	1-3	Tamil
16	Mr. MFM. Fazir Proprietor Lanka Polipack, Kurunegala,	26/8/2013 02.04 Minutes Interviewee's Shop, Lanka Polipack, Kurunegala	1-3	Tamil

Table 1.3 Continued:

No	Name, Profession / Occupation and Company / Organisation / Firm	Date, Duration and Place of Interview	Objectives Achieved	Language Used
17	Mr. TM. Irfan Managing Director ARAMCO International Foreign Employment Agency	26/8/2013 08.49 Minutes Interviewee's Office, ARAMCO IFEA, Kurunegala	1-3	Tamil
18	Mr. SH. Najeem Partner Al Reef Traders, Kurunegala	26/8/2013 09.22 Minutes Interviewee's Shop, Al Reef Traders, Kurunegala	1-3	Tamil
19	Mr. MRM. Wazeer Manager Choice Park, Matale	26/8/2013 33.45 Minutes Interviewer's Residence, 211, Bulugohatenna, Akurana	1-3	Tamil
20	Mr. HA. Khan Retired Chief Manager Peoples' Bank, Kurunegala	29/8/2013 05.48 Minutes Telephone Interview	1-3	Tamil

1.7.4 Tools for the Study

The following tools were employed for collecting the data for the study. These tools were validated properly.

1. Focus Group Interview

Focus group interviews were used to collect first-hand knowledge and hands-on experience from the sample regarding the developments and challenges of Takāful in Sri Lanka. The researcher developed an interview sheet to achieve this purpose. The interview sheet is divided into five sections: Research Question Code No., Research

Questions, Categories of Sample (Interviewees), Interview Question No. and Interview Questions. The copy of the Interview Sheet is given in Annexure A.

The interview questions were validated by the following experts in the field.

- Prof. Syed Masood Jamali, Senior Lecturer, School of Islamic Studies, B.S. Abdur Rahman University, Chennai, India.
- Dr. MAM. Shukri, Director, Jamiah Naleemiah, Beruwala, Sri Lanka.

They found the questions in the interview sheet substantial, systematic, and designed to provide the adequate and appropriate information to the research questions and objectives.

The responses received from the sample (Interviewees) were compared to other relevant documents and found to be consistent.

2. Content Analysis from Secondary Data

To collect further information, the researcher performed content analysis of books, research journals, websites, databases, government studies, reports, research papers from seminars, company documents, and other institutional publications and relevant literature.

To validate the data obtained from content analysis, data related to Islamic law were examined with the primary sources of Islamic jurisprudence, *Al-Qur'an* and *Al-hadīth*. In the event of inadequate and insubstantial evidence in the said sources, the researcher sought the ideas and interpretations of eminent *Shari'ah* scholars in regard to

these issues on the basis of *Ijmā'* and *Qiyās*. The data collected through content analysis was found to be valid and it was used in the study.

1.7.5 Procedure for the Study

To identify the research problem, the researcher reviewed a large number of literature including theses, journals, and books. With the assistance of the review and guidance of the supervisor, the tools for the study were developed. These tools were appropriately validated. The sample for the study was selected using purposive sampling.

The researcher analysed the contents of the related literature taking into account the research questions and the objectives of the study and other required information to discuss the findings and to write the report of the thesis. This information were categorised under suitable topics and used in the study where necessary.

The focus group interview was held with all the persons in the sample. Interviews were conducted mainly through face-to-face mode. The few interviewees who were inaccessible were investigated via telephone.

The responses recorded with the help of sophisticated appliances (mp3 recorder - SONY IC recorder- and Mobile Phone - Sony Ericson). Total time spent for all interviews was approximately 18 hours.

The recorded data by audio interviews were transcribed into text format and the interviews which were in Tamil were translated into English. This process took several months and there were 165 pages of transcribed data. These data were analysed in

reference of the research questions and objectives of the study and transformed into chapters of the thesis.

1.7.6 Analysis of the Data

The data obtained from the interviewees and content analysis from the secondary data were analysed using descriptive analysis. The researcher believes that this is the most suitable research design and method for this work to achieve its aims and objectives.

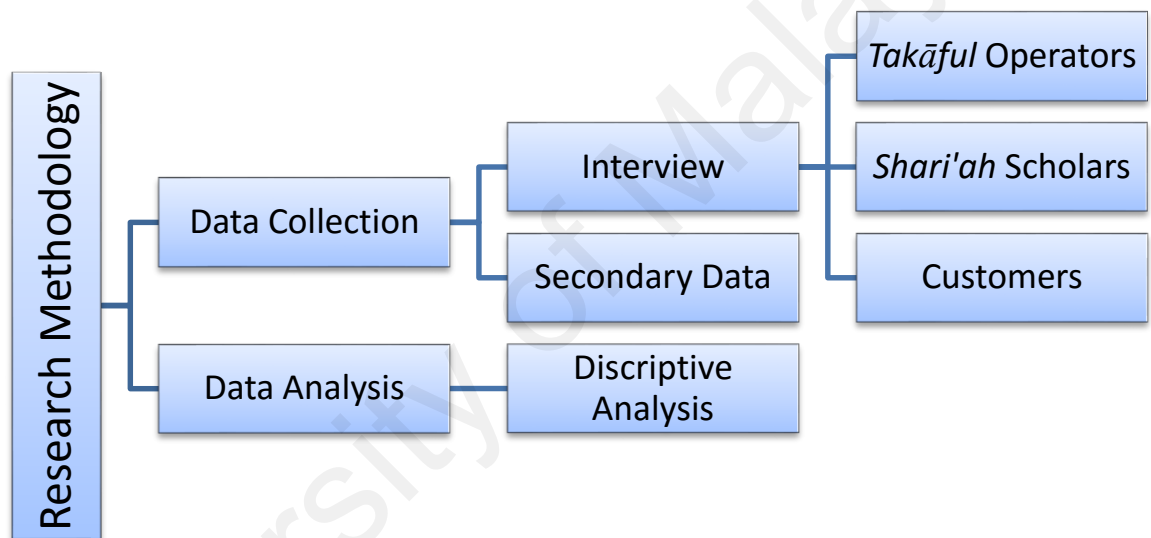


Figure 1.1: Methodology of the Study

1.8 Literature Review

The Islamic insurance (Takāful) system has a short history in Sri Lanka and there is little usable research in this area. With limited articles and only one magazine articles related to the subject of Islamic finance in Sri Lanka, these articles are insufficient when compared to the researches carried out in conventional insurance, Islamic corporate insurance, Takāful, Islamic economics and Islamic banking and finance. The topics of the

subjects reviewed by the researcher are provided in the table below and their in-depth analysis is given afterwards.

Table 1.4: Summary of Literature Review

Title	Name of Scholar/Association Cited
Meaning of Takāful	Malaysian Takāful Act No. (1984), Iqbal (2005), Bank Negara Malaysia, AAOIFI (2007), Ali & Odierno (2008), Archer, Rifaat Ahmed & Nienhaus (2009), Maysami & Kwon, Hassan (2011) and Nu Htay, Arif, Soualhi, Zaharin & Shaugee (2013)
Conventional Insurance and Takāful	Siddiqi (1985), Qal’aji (1997), Iqbal (2005), Maysami & Kwon, Ismail (2006), (2007), Frenz & Soualhi (2010), Farooq <i>et al</i> (2010), Khan <i>et al</i> (2011), Masud (2011), European Council for Fatwa and Research, Abdul Rahim, Lewis & Hassan Qaiser and Alhabshi (2011), Alrage.net and Nu Htay, Arif, Soualhi, Zaharin & Shaugee (2013)
Theory and Concepts Related to Takāful	Qal’aji (1997), Iqbal (2005), Sabbagh (2006), Ali (2006), Ali & Odierno (2008), Archer, Rifaat Ahmed & Nienhaus (2009), Farooq <i>et al</i> (2010) and Nu Htay, Arif, Soualhi, Zaharin & Shaugee (2013)
Growth and Potential of Takāful	The world Takāful report released by Earnst and Young (2010) and Shahrul Nizam
Takāful Models	Ali (2006), Ali & Odierno (2008), Archer, Rifaat Ahmed & Nienhaus (2009), Nu Htay, Arif, Soualhi, Zaharin & Shaugee (2013)

Table 1.4 Continued:

Title	Name of Scholar/Association Cited
<i>Mudārabah</i> Model	Iqbal (2005), Ali (2006), Abdul Rahim, Lewis & Hassan (2007), Ali & Odierno (2008), Archer, Rifaat Ahmed & Nienhaus (2009) and Nu Htay, Arif, Soualhi, Zaharin & Shaugee (2013)
<i>Wakālah</i> Model	Iqbal (2005), Ali (2006), Abdul Rahim, Lewis & Hassan (2007), Ali & Odierno (2008), Archer, Rifaat Ahmed & Nienhaus (2009), Bouheraoua & Ahmad (2011) and Nu Htay, Arif, Soualhi, Zaharin & Shaugee (2013)
Combined Model	Tolefat (2006), AAOIFI <i>Sharī'ah</i> Standards (2007), Archer, Rifaat Ahmed & Nienhaus (2009), Swiss Re (2011) and Nu Htay, Arif, Soualhi, Zaharin & Shaugee (2013)
<i>Waqf</i> Model	Raj (2007), Ali & Odierno (2008), Archer, Rifaat Ahmed & Nienhaus (2009), Farooq <i>et al</i> , (2010), Frenz & Soualhi (2010), Bouheraoua & Ahmad (2011) and Nu Htay, Arif, Soualhi, Zaharin & Shaugee (2013)
<i>Wakālah – Waqf</i> Model	Ali (2006), Abdul Rahim, Lewis & Hassan (2007) and Raj (2007)
Surplus	AAOIFI <i>Sharī'ah</i> Standards (2007), Sabbage (2010), Ali & Odierno (2008) and Frenz & Soualhi (2010)
General Takāful	Ali, & Odierno (2008), Yassin&Ramly (2011) and Yusof, Ismail & Naaim (2011)
Family Takāful	Maysami & Kwon, Ali & Odierno (2008), and Yassin & Ramly (2011)

Table 1.4 Continued:

Title	Name of Scholar/Association Cited
Takāful industry in Sri Lanka	Insurance Board of Sri Lanka, Annual Report (2010 and 2012)
Amana Takāful PLC	Zaheed (2010)
Ceylinco Takāful Limited	Mohideen (2007)
Challenges of Takāful Industry	Ali (2006), Mohideen (2007), Maysami & Kwon, Roslinah (2009), Archer, Rifaat Ahmed & Nienhaus (2009), Ali (2010), Ehsan Zaheed (2010), The world Takāful report (2011) and Staib (2011)

1.8.1 Meaning of Takāful

Takāful, meaning “guaranteeing each other”, “joint venture” and “shared responsibility”⁴ in Arabic, is an Islamic system of mutual insurance built around the concept of donation. Each participant contributes to a fund to cover expected claims, while benefiting a share of investment returns.⁵ It is the Islamic counterpart of conventional insurance, and exists in both life (family) and general forms.⁶

⁴ Maysami, R.C. and Kwon, W.J., n.d., An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism, p.7

⁵ Catherine, S.M. (2007), Takāful Article, No. 8, p. 1

⁶ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp. 3 & 4

It is a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants, in case of need whereby, the participants agree to contribute for that purpose⁷ based on the principles of ‘*Aqd* (contract).⁸ And it is a concept whereby a group of participants guarantee each other against loss or damage. Each participant fulfils his/her obligation by contributing a certain amount of donation or contribution⁹ (*tabarru’*)¹⁰ into a fund, which is managed by a third party - the Takāful operator.¹¹ The resources of this fund are used to indemnify any participant who encounters injury, subject to a specific set of rules and a given process of documentation. The fund is managed by either a selected group of policyholders or a joint stock company that manages the insurance operations and invests the assets of the fund, for a specific fee.¹² The operator’s role is restricted to managing the insurance operations and investing the insurance contributions” (Financial Accounting Standards No. 12, in Appendix E)¹³

Takāful life insurance works both as a savings instrument where participants set their own target amount to accumulate over a certain period, and as a protection mechanism in which all participants guarantee each other against certain events that would alter their financial status. In contrast, Takāful non-life insurance works more like

⁷ Takāful Act (1984), Bank Negara Malaysia, p.6

⁸ Rusni Hassan (2011). (2nd Edition) Islamic Banking and Takāful, p.260

⁹ Maysami, R.C. and Kwon, W.J., n.d., An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism, p.7

¹⁰ *Sharī’ah* scholars accept uncertainty in contracts for one-sided transfers (*tabarru’*) such as endowments or donations. Therefore, they base Takāful schemes as the Islamic alternative to insurance on the concept of “donations” (voluntary individual contributions) to a risk pool out of which indemnities are paid to other contributors. The term “donation” may be somewhat misleading because there is no recipient who can dispose of the donated funds at his will, and the motive of the donor is not altruism or the wellbeing of others but a claim to benefits for himself in case of damage. The result is a “conditional donation”, which is in confirmatory with *Sharī’ah*. Archer, Abdel Karim and Nienhaus, *Takāful Islamic Insurance*, p.9

¹¹ http://www.bnm.gov.my/index.php?ch=fs_mfs&pg=fs_mfs_bank&lang=en#Takaful accessed on 27 July 2012

¹² AAOIFI (2008). *Sharī’ah Standards for Islamic Financial Institutions*, p.471

¹³ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). *Essential Guide to Takāful (Islamic Insurance)*, pp.3 & 4

a joint guarantee in which all participants contribute their own shares of premiums into a pool and agree to indemnify those participants who suffer from an insured peril. Muslim jurists agree that Takāful insurance is in accordance with *Sharī'ah* and *ḥalāl* and deeply imbeds the concept of *tabarru'*.¹⁴

1.8.2 Conventional Insurance and Takāful

Based on the debate that is going on as to whether conventional insurance as practiced all over the world is lawful under the *Sharī'ah*, there are three viewpoints on the issue.

1. Conventional insurance is fully *Sharī'ah* compliant.
2. It is permissible under certain conditions.
3. It is fully prohibited.

Some Muslim scholars like Al-Zarqa, Al-Khafif, Abd al-Rahman 'Īsa, Yusuf Musa, Al Rajihi¹⁵ and councils of Islamic jurisprudence i.e. council of the Academy of Canonists of Muslim World League, view conventional insurance as a lawful practice in Islam. As Maysami and Kwon¹⁶ say:

“The Council of the Academy of Canonists of Muslims World League uphold the position that the original legal position on any matter is permitted until there is evidence that it should be prohibited. Insurance is then allowed because there is no specific injunction in the *Sharī'ah* against it and a mere presumption is insufficient to declare insurance as unlawful. The legal maxim postulates that all is acceptable in Islam, unless it has been expressly prohibited’.¹⁷

¹⁴ Maysami, R.C. and Kwon, W.J., n.d., An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism, p.7

¹⁵ www.المنشآت العامة > [القسم العام](http://www.القسم العام) alrage.net, p.2, accessed on 10 October 2012

¹⁶ Maysami, R.C. and Kwon, W.J., n.d., An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism, p.7

¹⁷ Sufyan Ghulam Ismail (2006). Insurance Revisited -The *Sharī'ah* View, New Horizon, © 2011 Institute of Islamic Banking and Insurance, www.newhorizon-islamicbanking.com accessed on 22 April 2012, pp. 4 and 5

They¹⁸ further suggest that insurance benefits society as it helps to alleviate the losses of the unfortunate through pooling individual contributions, which is consistent with the *Sharī'ah*. Accordingly, they view that insurance is accepted as long as it is intended for a good cause.

In recent times though, numerous other scholars have written authoritative literature on the need to reassess the basis of the old prohibition. These contemporary scholars have argued that insurance is neither a form of gambling nor is it an activity, which inherently promotes interest. Furthermore, they assert that it cannot be construed as prohibited simply because it does not fit neatly into any prevailing form of Islamic financial contract.¹⁹

An influential Islamic scholar, Mustafa al-Zarqa, made an argument for the acceptability of conventional insurance practices as insurance contracts in the aggregate pose very little uncertainty, since the risk for which the parties are contracting can be valued.²⁰

It is also postulated that necessity and compulsion under law can be treated acceptable justification to make conventional insurance lawful. It is well known that in most non-Islamic countries there are cooperative and mutual insurance companies. There is no harm from the *Sharī'ah* point of view to participate in these services. So, it is unlawful for a Muslim living in a country where there is such a cooperative insurance company to make an agreement with a commercial insurance company. But, if a

¹⁸ Maysami, R.C. and Kwon, W.J., n.d., An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism, p.7

¹⁹ Sufyan Ghulam Ismail (2006). Insurance Revisited -The *Sharī'ah* View, New Horizon, © 2011 Institute of Islamic Banking and Insurance, www.newhorizon-islamicbanking.com accessed on 22 April 2012, p.2

²⁰ Hania Masud (2011). Takāful: an innovative approach to insurance and Islamic finance, University of Pennsylvania Journal International Law, Vol. 32:4, p.1141

cooperative insurance company is not found one may enter into a contract with a commercial insurance company only by way of necessity. If a person is forced by law to insure or by way of need, it is obligatory for him to be content with the minimum proportion of insurance that covers his need or to the minimum of such transaction he is being forced to carry out.²¹

By contrast, many other scholars and jurists like, Bukhait, Al Ghazzali, Al Qardawi,²² Taqi Usmani,²³ Khan, Ahmad, Iqbal, and Ali,²⁴ Qaiser,²⁵ Alhabshi,²⁶ Frenz, and Soualhi²⁷ and Maysami and Kwon²⁸ opine that the conventional insurance is not permitted in Islamic *Shari'ah* due to the presence of unlawful elements in its contracts and practices. Abdul Rahim, Lewis and Hassan²⁹ elaborate that *gharar* (uncertainty), *maisir* (gambling) and *ribā* (interest) are the main problems with conventional insurance.

To emphasise this view, there are some *fatwas* (فتاوى) delivered by authentic Islamic *Shari'ah* organisations. For an example: First international conference on Islamic economics held in 1976 concluded with, “The conference sees that the commercial

²¹European Council for *Fatwa* and Research, www.islamonline.com, Available at www.takaful.coop p.2

²²www.المنتديات العامة > القسم العام alrage.net, p.2, accessed on 10 October 2012

²³Taqi Usmani, M., Several Questions about Insurance and interest, accessed through <http://ebookbrowse.com/gdoc.php?id=32009164&url=3cdc4ce0fc1089e24749fa513b0c4e2b> on 20 October 2012, p.1

²⁴Munawar Khan, M. Naveed Ahmad, Iqbal, M.S. and Salmat Ali (2011). Comparative Analysis of Islamic and Prevailing Insurance Practices, International Journal of Business and Social Science Vol. 2 No. 10, pp. 283-286

²⁵Qaiser, R. Takāful – The Islamic Insurance, Pune:NIA, pp. 2-4

²⁶Alhabshi, S.A. (2011). Takāful: Background, Branding and Concept, Malayan Law Journal Articles/2011/Volume 6, p.3

²⁷Frenz, T. and Soualhi, Y. (2010).(2nd Edition), Takāful & Retakāful – Advanced Principles & Practices, pp. 118-123

²⁸Maysami, R.C. and Kwon, W.J., n.d., An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism, p.6

²⁹Abdul Rahim, A.W., Lewis, M.K. and kabir Hassan, M. (2007).Islamic Takāful: Business Models, *Shari'ah* Concerns, and Proposed Solutions, Thunderbird International Business Review, Vol. 49(3) 371–396, pp. 374-377

insurance which is practiced by the commercial insurance companies in this era does not conform to the *Sharī'ah* principle of cooperation and solidarity because it does not fulfil the *Sharī'ah* conditions which would make it valid and acceptable".³⁰ Council of Islamic Ideology of Pakistan in 1983 rejected all the models of commercial insurance.³¹ The similar *Fatwā* was declared at the *Fiqh* Academy's Islamic conference in Jeddah in 1985.³² Conventional insurance have been decreed as unlawful by regulators such as the National Council for Islamic Religious Affairs of Malaysia. The pure Islamic nature of Takāful gets strong support from many '*ulama*'s. In February 16, 2006 Takāful approval was signed by Justice Taqi Usmani and other religious '*Ulama*' of Pakistan.³³

Differences between conventional insurance and Takāful insurance are very obvious. Takāful operates in such a way that the participants contribute their money and formulate a pool of money. This money is then invested to earn *ḥalāl* profit in *Sharī'ah* compliant investments. The amount of profit earned is then added in money pool and is then distributed among the participants after satisfying any claim as a renewal discount. The Takāful operator only receives *Wakālah* fee.³⁴

Conventional insurance operates differently. The premium that is paid by policy holders to the insurance company is invested by the insurance company in interest bearing and other non-*Sharī'ah* compliant investments. All income including interest and profit on investments received by insurance companies and the surplus are retained by the

³⁰Syed Umar Farheook, Chaudhry, Fakhr-e-Alam and Ahmad (2010). An Analytical Study of the Potential of Takāful Companies, European Journal of Economics, Finance and Administrative Sciences, p.57

³¹Munawar Khan, M. Naveed Ahmad, Iqbal, M.S. and Salmat Ali (2011). Comparative Analysis of Islamic and Prevailing Insurance Practices, International Journal of Business and Social Science Vol. 2 No. 10, p. 283

³²*Ibid*, p. 283

³³ Munawar Khan, M. Naveed Ahmad, Iqbal, M.S. and Salmat Ali (2011). Comparative Analysis of Islamic and Prevailing Insurance Practices, International Journal of Business and Social Science Vol. 2 No. 10, p. 285

³⁴ *Ibid*, pp. 283-286

company without distributing it among policy holders. Only claims are met with this surplus and investment income.

Islamic insurance companies invest in a variety of *Sharī'ah* compliant products. Governments of countries in which Muslims are a majority, have introduced a legal framework to facilitate the development and introduction of new *Sharī'ah* compliant investment products. *Muḍārabah* investments, *Sukuks*, *Halāl* share market trades, are some of the instruments which have evolved from such state patronage. Conventional insurance companies invest in a wide range of interest based instruments like treasury bills, interest bearing bank deposits, interest bearing bonds and also invest in products that are strictly forbidden by *Sharī'ah*, e.g. Shares of companies whose core activity involves the production, sale, marketing etc. of alcohol, entertainment, non *Ḥalāl* meats, gambling etc.³⁵

The goal of conventional insurance companies is to maximise profits for shareholders. They are profit driven stock companies with little to no consideration for ethics. By contrast, the goal of Takāful is the wellbeing of society. Profit is not the only driving force. Takāful helps people accumulate their savings for the good of the community. An opportunity is provided by Takāful to enable people to practice risk management in an Islamic manner. The Holy Prophet (PBUH)³⁶ says: “Whoever removes the hardship from a believer, Allah will remove hardship from him on the day of judgment”.

³⁵Frenz, T. and Soualhi, Y. (2010).(2nd Edition), *Takāful & Retakāful – Advanced Principles & Practices*, p. 122

³⁶*Sahih Muslim*, 1998, vol. 4, Chapter 11, *Hadith* No:2699, pp. 233-234

In Takāful, investment income is shared with policy holders on the basis of *Mudārabah* principles, while in conventional insurance profit is not shared with policy holders.

The Takāful fund is managed by the operator but ownership of the fund is vested with participants. They have a complete ownership right of funds contributed and benefits. In conventional insurance the policy holder purchases the policy and there exists only a seller – purchaser relationship. They have no rights over the fund. The Takāful company performs the role of trustee and operates the fund on the basis of mutuality.

Conventional insurance contracts give absolute authority to the insurer to forfeit the premium amount that is paid by the policy holders unless certain conditions are met. Islam does not allow the forfeiture of the premium in whole or in part as the premium is considered a loan given by the insured to the insurer rules are made according the holy *Qur'an* and the *Hadith* in the Takāful system.

In conventional insurance, rules are made for the sole purpose of maximisation of profit. The agent gets a specific percentage of commission from the amount paid by the policy taker. In Islamic insurance, the agent (*wakīl*) (وكيل) is considered the employee of the Takāful operator and only gets a salary for his services. In conventional life insurance, outside parties (not necessarily the heirs) can have an insurable interest on the policy holder's life, whereas in Islamic life insurance the insurable is vested according to the *Wasīyyah* (وصية) principle.

The *Sharī'ah* advisory committee is a significant feature in Islamic financial companies which advises the management and ensures that their activities comply with *Sharī'ah* principles.³⁷

In short, there are five specified elements in Takāful insurance. Firstly, Mutual Guarantee - the basic objective of Takāful is to pay a defined loss from a defined fund. The loss is borne by a fund created by the donations of policyholders. The liability is spread among the policyholders and all losses divided between them. In effect, the policyholders are both the insurer and the insured. Secondly, Ownership of Fund - donating their contributions to the Takāful fund, policyholders become owners of the fund and entitled to its profits (this varies slightly between the adopted models which are described later). Thirdly, Elimination of Uncertainty - donations, causing transfer of ownership to the fund, are voluntary to help with a policyholder's loss without pre-determined monetary benefit. Fourthly, Management of the Takāful Fund - management is by the operator who, depending on the adopted model, utilises either (or a combination) of two *Sharī'ah* compliant contracts, namely *Muḍārabah* or *Wakālah* and finally, in investments. All investments must be *Sharī'ah* compliant, which prohibits investment in *ḥarām* industries and requires the use of instruments free of *ribā*.³⁸

1.8.3 Theory and Concepts Related to Takāful

The Takāful insurance system is formed on Islamic theories enshrined in *Al-Qur'an* and *Al-Sunnah*. One of the most important theories of Takāful is *Ta'āwun* (تعاون) – mutual assistance. It is based on some Qur'anic verses, teachings of Prophet

³⁷Yassin, N., and Ramly, J (2011) Takāful: A Study Guide, p. 125

³⁸ Ernst & Young, World Takāful Report, 2012, p. 12

Muhammad (PBUH) and Islamic legal maxims (قاعدة فقهية) such as “*al-darar yuzāl*” (الضرر يزال); meaning: ‘damage or harm is removed’.³⁹ This will be discussed in detail in chapter two.

Takāful is a concept of mutual cooperation 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 fulfils the social obligations towards financial assistance. Takāful is a service to the Muslim *Ummah*. It is a welfare scheme. The Takāful mechanism is an example of how the principles of Islamic *Shari’ah* can help create new socioeconomic mechanism based on equity, justice, and fair play.⁴⁰

By ensuring financial assistance in times of need and providing indemnity against accidental loss of property, Takāful serves the public interest and, therefore, can play an important role in society. The family Takāful system facilitates capital formation of individual households. The collective surplus funds can be invested for the social welfare projects and economic development of the community. General Takāful schemes can facilitate trade, commerce, and optimum utilisation of resources. The Takāful mechanism also encourages *Muḍārabah* as a mode of investment and can play a key role for the betterment of Muslim society throughout the world.⁴¹

Takāful insurance is found in recorded history. In the pre-Islamic period, different kinds of insurance were found in the Arab world. The first constitution in Madinah of 622 AD contained codified references to social (wergild or blood money to rescue an accused

³⁹ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p.7

⁴⁰ Mortuza Ali, K.M. (2006). Basis and models of Takāful: The need for *Ijtihād*, Takāful, Articles No: 03, pp.1 and 2

⁴¹ *Ibid*, pp.1 and 2

in accidental killings), *fidyah* (الفدية) (ransom of prisoners of war),⁴² and cooperative schemes to aid the needy, ill, and poor.⁴³

'*Al- 'āqilah*' (العاقلة) is another form of insurance found in the pre-Islamic period. It is a system wherein one commits a non-premeditated murder, where it requires blood money and not vengeance. The blood money of the murdered soul is normally shared between the members of his tribe and it is paid in instalments over three years. The members of the tribe help each other and Islamic law binds them to remedy the impact of the harm caused by the murder by mistake in equal instalments. It is the distribution of the financial obligation in a catastrophe of murder by mistake through obligatory donation. This is similar to mutual insurance that is based on Takāful to remedy the effects of the catastrophe and dangers by way of obligatory donations.⁴⁴

1.8.4 Growth and Potential of Takāful

Islamic finance has secured and manages 1 trillion US Dollars in assets and is growing rapidly. The industry has attracted the attention of most finance professionals and has been acknowledged as the fastest growing industry in the world. It comprises of three sectors namely Islamic banking, Islamic capital market, and Islamic insurance (Takāful). Although Takāful is the slowest growing segment of the Islamic financial industry, it has generated a vast interest among investors and insurance providers.⁴⁵

⁴² Safi-ur-Rahmen, (1996). *Ar-Raheeq Al-Makhtūm* (The Sealed Nectar) Biography of the Noble Prophet, In Ibn Hishām, 1/502,503, P. 190

⁴³ Syed Umar Farook, Chaudhry, Fakhr-e-Alam and Ahmad (2010). An Analytical Study of the Potential of Takāful Companies, *European Journal of Economics*, p.56

⁴⁴ Sabbagh, A.M. (2006). Islamic Cooperative Insurance (paper submitted at World Takāful Conference – Dubai UAE April 2006), © 2011 Institute of Islamic Banking and Insurance, pp.2and3

⁴⁵ Shahrulnizam A. H.M., n.d., Sharī'ah issues in Takāful: A Brief assessment through Literature Review and the opinions of Industry Experts, accessed on 22 April 2012, p.2

The global Takāful contribution grew 28% in 2008 to reach US\$ 5.3 billion and remain on course to surpass US\$ 14 billion by 2014.⁴⁶ The premium is projected to increase to US\$12.5 billion by 2015 with over US\$30 billion in funds. Interestingly, this figure for 2015 was revised from an earlier similar estimate of \$7.5 billion done in 1999, which in a way indicates that business expectations may be materialising at a faster pace, driven to a large extent by strong market growth in the Gulf region and Malaysia. Nowadays, the Takāful industry is populated by 110 operators worldwide (Now approximately 200 operators). Surprisingly, the American Insurance Group (AIG) is the largest Takāful fund operator in the world.⁴⁷

Takāful or Islamic insurance is a relatively new industry. Although the origin of Takāful can be traced to Islamic practices 14 centuries ago, the development of Takāful in modern times was initially undertaken in Sudan in 1979 and Malaysia in 1984. The culmination of this initial development was encapsulated within the 1985 *Fiqh* Academy ruling declaring that conventional commercial insurance was *ḥarām* (forbidden) and insurance based on the application of cooperative principles, *Shari'ah* compliance, and charitable donations was *ḥalāl* (acceptable).

During the past two decades, we have seen Takāful operations opening up in many countries throughout the world, primarily in Islamic countries and countries with a large Muslim community. In the Far East, Malaysia has been at the forefront of Takāful development with Bank Negara taking the lead with the introduction of separate Takāful regulations allowing the Takāful business to flourish in that country.

⁴⁶ Earnst and Young (2010). Global Takāful insight, p.7

⁴⁷ Shahrul Nizam A. H.M., n.d., *Shari'ah* issues in Takāful: A Brief assessment through Literature Review and the opinions of Industry Experts, accessed on 22 April 2012, p.2

Outside the Far East and Middle East, Takāful has also been introduced to Europe and the USA. During 2006 and 2007, a significant number of Takāful and retakāful operations were established by major conventional re/insurance players (e.g. Munich Re, HSBC, Hannover Re, Prudential, AIG, Tokio Marine, and Swiss Re in 2006; Aviva and Allianz in 2007).

Taking into consideration the massive attention that the Islamic finance industry is gaining, it is a real possibility that this industry, with its three main sectors, will grow faster than expected. For Takāful industry, the low penetration rate of Takāful and insurance is a clear indication of a better future. Swiss Re's research publication, *Sigma*, demonstrates that less than 1% of GDP per capita is spent on insurance premiums in most of the Middle Eastern countries even where affordability is not an issue.

Within Asia, Pakistan, Bangladesh, and Indonesia—all with largely Muslim populations—the percentage spent are between 0.1 to 0.3%. In India, the GDP and socioeconomic conditions being somewhat similar, and the Muslim population being some 15% to 20% (which accounts over 160 million Muslims), the percentage of GDP spent on insurance is 0.6%.⁴⁸ This indicates that among Muslims, the low insurance penetration also relates to religious beliefs, besides other reasons.

Penetration is greater on the non-life side, perhaps due to compulsory insurance requirements in many areas of non-life business. Muslims are more reluctant for insuring their lives (life, health, and personal illness) due to religious concerns. Therefore, it is a

⁴⁸ Shahrul Nizam A. H.M., n.d., *Shari'ah issues in Takāful: A Brief assessment through Literature Review and the opinions of Industry Experts*, accessed on 22 April 2012, p. 6

big opportunity for Muslims to expand the Takāful industry into Muslim markets, and grow the industry even faster.

Takāful insurance has potential to grow rapidly in future years because Islam is the fastest growing religion in the world and Muslims constitute the largest religious group in the world. There is now a greater tendency among Muslim populations worldwide to opt for religion based solutions to problems they face, be it social, economic, or others.

With the growth and development of the ‘ethical investment’ segment, Takāful is attractive to non-Muslim customers due to its distinctive features of transparency over product profitability. The principle of profit sharing and the ethical selection of investments (e.g. no alcohol, no gambling) is also gaining popularity. In Malaysia, Takāful is popular among Muslims and non-Muslims. For example, over one-quarter of the policyholders in one of the Takāful operators in Malaysia are non-Muslims.⁴⁹

Moreover, Takāful products are available to meet the needs of all sectors of the economy at corporate and individual levels. There are exclusive Takāful insurance companies operating in many countries and there are traditional insurance companies operating with “Takāful Windows”. There are now retakāful providers operating worldwide.

Another important development is the emergence of a significant market for Takāful. Islamic *Shari’ah* contains basic rules of ethics which provide ample scope to innovate more models and products in Takāful. The increasing acceptance of the Takāful

⁴⁹ Oliver Wyman (2007), Takāful: A new global insurance growth opportunity, p.5

concept and increased levels of business from compulsory lines and corporate business should help provide a regular and stable stream of business to the Takāful industry.

Although challenges persist in the Takāful sector, we believe that the potential for sustained growth and development is significant.

1.8.5 Takāful Models

There are two main systems in the Takāful operational model. One is the purely non-commercial Takāful system. In this cooperative system, all participants agree to manage their Takāful fund themselves and there is no external interference or management in this arrangement. They are guaranteeing each other with the Takāful fund, sometimes they may engage in commercial activities within themselves. This method is similar to traditional mutual companies. Generally, regulatory and legal issues and complexities are lower than operations based on commercial lines. Nevertheless, this method can be operated in a community, where the participants are capable, conscious, and knowledgeable about operational parts of insurance. And also there should be funds available to start the venture. Moreover, government support is needed for the continuity of the business. This system has been used mostly in Sudan.

Many Muslim scholars suggest that purely cooperative or mutual forms of insurance can be the basis of Islamic insurance. This model of insurance can be operated in a society where the participants are conscious and capable of running the technical aspects of insurance operation. Moreover, funds should be available to start the venture.

Therefore, the commercial model is practiced.⁵⁰ In the non-commercial model, there is little room for entrepreneurial spirit and there are significant difficulties in raising capital. The model is normally used by government-backed Takāful operations to meet the specific needs of people in the country.⁵¹

The other is the commonly used commercial Takāful system. In this system, different models have evolved and are being practiced over the years. Whatever the mode of operation, there will be common basic elements such as cooperation and mutuality, accountability, and transparency which are lawful in *Sharī'ah*. These operational models are described below.

1.8.5.1 Muḍārabah Model

In Islamic transactional law, *Muḍārabah* means: one person giving an amount of money to another person who will trade with the given capital and share the profits generated according to a pre-agreed ratio or percentage.⁵² Currently, this system is widely used by Islamic banks. The Takāful operators also utilise this system for their investment venture.

Some Muslim scholars realised certain *Sharī'ah* issues regarding the operation of the *Muḍārabah* system in Takāful. Notably, Yacoubi and Abu Ghuddah, as well as AAOIFI (Accounting and Auditing Organisation for Islamic Financial Institutions), have

⁵⁰ Mortuza Ali, K.M. (2006). Basis and models of Takāful: The need for *Ijtihād*, Takāful, Articles No: 03, p. 3

⁵¹ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 43

⁵² Authors of Fundamentals of Takāful define Muḍārabah as “a profit-loss sharing principle applied normally to a business or commercial contract between the party that provides the fund or capital and the party that manages the business. For Takāful this would mean the contract of profit sharing between the Takāful participants and the operator from the profit, if any, of the Takāful business. Fadzli Yusuf, M., Wan Ismail, W.Z., and Mohamed Naaim, A.K. (2011). Fundamentals of Takāful, p. 34

brought into question the use of a *Muḍārabah* contract in certain Takāful operations. The two main objections for its use have been the intermingling of the participant's contribution with *tabarru'* and *Muḍārabah* capital. Due to the fact that a Takāful or insurance operation creates surplus instead of profits and therefore the use of a profit sharing contract may not be appropriate.

Others questioned the Islamic legality of this operation. The objective is to pay for a defined loss from a defined fund, which is set up by policyholders but is managed by a Takāful company. The contributions are based on the principle of *tabarru'*. A *tabarru'* is a one-way transaction in which once the contribution is paid, the contributor has no right to take any benefits out of it. Rather, the fund is used for any participant who faces financial difficulties or losses within the period as agreed upon in the insurance policy. A number of issues arise. Whether the cooperative concept exists in the mindset of Takāful operators as well as in participants. From a *Sharī'ah* view point, questions are raised whether *tabarru'* contributions can be treated as capital for *Muḍārabah*. At the same time, the sharing of underwriting surplus renders the contract essentially the same as conventional insurance contracts. The requirement of the operator to provide a top-up interest free *qarḍ ḥasan* (قرض حسن) (in case of a deficit) in a *Muḍārabah* contract by definition is against the concept of *Muḍārabah* because the *Muḍārib* cannot be a guarantor.⁵³

The same queries were taken up for consideration in the *Ijmā'* meeting of over 40 *Sharī'ah* scholars which was organised by Dārul Uloom, Karachi. This included scholars from different institutions in the country as well as from Bangladesh and Abu Ghuddah

⁵³ Abdul Rahim, A.W., Lewis, M.K. and Kabir Hassan, M. (2007). Islamic Takāful: Business Models, *Sharī'ah* Concerns, and Proposed Solutions, Thunderbird International Business Review, Vol. 49(3) 371–396, pp. 380 and 381

from the Middle East.⁵⁴ Others argued that the purpose of using the *Muḍārabah* instrument for investment is to allow the fund to grow, rather than leaving it idle while waiting for claims or payment of other expenses.⁵⁵

Further, they say that this is one of the earliest models of Takāful operation, especially in Malaysia, during the initial phase of the introduction of Takāful in the country. The *Muḍārabah* model is also known as the “profit sharing model”. Two versions were generally developed. One included only investment profit sharing (sometimes called “pure” *Muḍārabah*) and another also included the sharing of underwriting surplus (Sometimes called “modified” *Muḍārabah*).⁵⁶

1.8.5.2 *Wakālah* Model

Wakālah (وكالة) means agency. One person acts as agent (*Wakīl*) (وكيل) for another person in a transaction, agreement etc. *Wakālah* is permitted by *Al-Qur'an* and *Al-Sunnah* and it has been widely accepted by *Sharī'ah* scholars.

In a *Wakālah* Takāful model, the participants contribute to the Takāful fund as a donation or *tabarru'*. Then, the participants as a group appoint and authorise the Takāful operator to be their agent (*Wakīl*) to manage the Takāful fund for both “insurance” as well as investment activities. The Takāful operator charges a *Wakālah* fee for their

⁵⁴ Abdul Rahim, A.W., Lewis, M.K. and kabir Hassan, M. (2007). Islamic Takāful: Business Models, *Sharī'ah* Concerns, and Proposed Solutions, Thunderbird International Business Review, Vol. 49(3) 371–396 pp.4 and 5

⁵⁵ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp. 33 and 34

⁵⁶ *Ibid*, pp. 43 and 44

management responsibilities.⁵⁷ Issues related to the underwriting surplus have been discussed in the section 1.8.6 under the title “Surplus”.

There are two different systems in operation in Takāful companies which operate on the *Wakālah* model and these exist mostly exist in the Gulf countries. One is a pure *Wakālah* system. Under this system, the operator gets a fixed amount of fee for the services rendered. Normally, the fee is fixed annually in advance in consultation with the *Sharī’ah* supervisory board. The other system is the modified *Wakālah* system where a percentage share of the underwriting surplus is paid as a performance incentive to the operator.⁵⁸

Although *Sharī’ah* scholars agree with the conceptual basis underlying the basic *Wakālah* model, they have expressed concern and have proposed solutions which might better address those concerns.⁵⁹

First, under a typical *Wakālah* model, the *tabarru’* (donation) remains the property of the participants unless consumed, as they have the right to receive the surplus back and therefore it becomes a conditional gift. This feature, in turn, gives rise to issues such as inheritance (not possible to measure the share of surplus in the pool at time of death) and *Zakāh* in in the case of the death of the participant, as the donation is a conditional gift. Also, the relationship is between the participants and the operator and

⁵⁷ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp.49-52

⁵⁸ Mortuza Ali, K.M. (2006). Basis and models of Takāful: The need for *Ijtihād*, Takāful, Articles No: 03, p.4 and Said Bouheraoua and Ali Jinnah Ahmad, M. (2011). Takāful Operation: Appraisal of the Existing Models and Exploration of a possible alternative, the *Wadi’ah* Model, *Revue des Sciences Economiques et de gestion*, N 11, pp.13 and 14

⁵⁹ Abdul Rahim, A.W., Lewis, M.K. and Hassan, M.K. (2007). Islamic Takāful: Business Models, *Sharī’ah* Concerns, and Proposed Solutions, *Thunderbird International Business Review*, Vol. 49 (3) 371–396, pp. 386 and 387

also among the participants (exchange of gift for a gift). As such, doubts are created about the contract becoming a contract of compensation.

Second, there are various generational matters. For example, contingency reserves may not be equitable between generations as the operator is likely to hold higher proportionate reserves in the early years for future contingencies. Since the participants keep changing on a continuous basis, it leads to an intergenerational equity issue. In a pure pooling arrangement, one should be able to call on members to contribute more in the case of a deficit on a pro-rata basis. This is not seen as practical in retail commercial insurance, and therefore alternative solutions may need to be explored for Takāful.

Third, another generational issue arises from the *qard ḥasan* for deficits. This is an obligation on shareholders that would be returned by future generations and differs from those that may have given rise to the deficit, as the participants keep changing on a continuous basis. Related to this, the *Wakīl* should not be the guarantor of the participants he represents.⁶⁰

This third concern is considered to be less serious than the two earlier ones. Solutions can be sought to these issues within the *Wakālah* model as in principle this model is well accepted by most scholars from a *Sharī'ah* perspective. It is notable that these three issues apply not only to the *Wakālah* model of Takāful, but apply equally to other models as well.

⁶⁰ Abdul Rahim, A.W., Lewis, M.K. and kabir Hassan, M. (2007). Islamic Takāful: Business Models, *Sharī'ah* Concerns, and Proposed Solutions, Thunderbird International Business Review, Vol. 49(3) 371–396, pp. 386 and 387

1.8.5.3 Combined Model

The combined or hybrid model is a mixed model of *Muḍārabah* and *Wakālah* models. Referring to a Swiss Re report, when the combined model operates the agent receives a pre-agreed share of the contributions paid by policyholders plus a share of the profits earned on investment activities. Applying the *Muḍārabah* model to investment activities helps mitigate the principal-agent problems, whereas the use of the *Wakālah* model allows the operator to recover the administrative costs of underwriting”.⁶¹

The mixed model of *Wakālah/Muḍārabah* is the dominant model in the Middle East market and it is widely practiced by Takāful companies worldwide.⁶² It is also recognised and recommended by AAOIFI⁶³ to be adopted by Takāful companies. Furthermore, the Bahrain Monetary Agency (BMA) has only allowed *Wakālah* and mixed models to be adopted by Takāful companies operating in the Kingdom. This system is legalised in Pakistan by Takāful rules of 2005.⁶⁴

1.8.5.4 Waqf Model

Waqf (وقف) is a good deed encouraged by the *Sharī'ah*. Normally, it is used for charitable activities, for developing and maintaining of mosques, Islamic religious schools, cemeteries, orphanages etc. It has been practiced by the Muslims throughout history to strengthen religious rituals, education, safeguard of historic places and relieving hardships.

⁶¹ Swiss Re (2011). *Islamic Insurance Revisited*, Kuala Lumpur, Malaysia: Swiss Reinsurance Company limited, p.6

⁶² Abdulrahman Tolefat (2006). *Mixed model is best approach*, Takāful Articles No: 06, p.1

⁶³ AAOIFI, 2007, *Sharī'ah Standards for Islamic Financial Institutions*, No: 26, p.472

⁶⁴ http://www.secp.gov.pk/corporatelaws/pdf/mar_29_05_TakafulRules.pdf accessed on 20 October 2012

Taqi Usmani believes strongly in the *Waqf* model. He feels that *Waqf* is more compatible with the cooperative concept of Takāful as it is created for the very purpose of cooperation. He said that if one establishes a fund for Takāful, then the fund should have a legal entity. Whenever one contributes to this fund, the contribution is for the common good. When the *Waqf* fund distributes the funds between the members according to its own rules, the fund needs to have its own legal entity. According to Islamic jurisprudence, *Waqf* is an independent entity, hence he prefers this model.⁶⁵

The *Waqf* model focuses on the *tabarru'* aspect of Takāful. The management and operational aspect of the Takāful fund may still use the *Wakālah* and *Muḍārabah* contracts.⁶⁶ In the *Waqf* model, a *Waqf* fund is established by the shareholders and the participants will contribute to the *Waqf* fund. The operator will receive a pre-agreed management fee for underwriting services and share the *Muḍārabah* investment profits based on a pre-agreed profit sharing ratio. In this model, the Takāful operator will play two different roles, first as a manager and then as a *Muḍārib*. The *Waqf* fund will be used for claims, retakāful and reserves. Any surplus in the *Waqf* fund will be distributed as per the *Waqf* deed which normally distributes it to the participant kept as a reserve or utilised for charitable purposes.⁶⁷

⁶⁵ Shakun Ashoka Raj (2007). MIR Takāful models, p.88

⁶⁶ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 55 and Syed Umar Farook, Chaudhry, Fakhr-e-Alam and Ahmad (2010). An Analytical Study of the Potential of Takāful Companies, European Journal of Economics, Finance and Administrative Sciences, p.59

⁶⁷ Said Bouheraoua and Ali Jinnah Ahmad, M. (2011). Takāful Operation: Appraisal of the Existing Models and Exploration of a possible alternative, the *Wadi'ah* Model, Revue des Sciences Economiques et de gestion, p.15 and Frenz, T. and Soualhi, Y. (2010).(2nd Edition), Takāful & *Retakāful* – Advanced Principles & Practices, pp.145

1.8.5.5 *Wakālah – Waqf Model*

Some *Sharī'ah* scholars have critically analysed the *Wakālah* system and suggested to incorporate the concept of *Waqf* into the *Wakālah* model. Under this revised combined model, the operator would initially make a donation to establish a benevolent fund called the *Waqf* fund. When this *Waqf* is created, the shareholders will lose their ownership rights on the *Waqf*. However, this fund will be administered by the operator.

The donations received from the participants, seeking Takāful protection, will also be deposited into this fund and the combined amount will be used for investment. Profits earned will be deposited into the same fund. Participants will be given benefit from this *Waqf* fund. The *Waqf* fund would be allowed to form contingency reserve fund apart from usual technical reserves. The *Waqf* fund rules would define the basis for compensation and financial help, and rules for sharing surplus between the members and operators.⁶⁸

In this modified *Wakālah* model with *Waqf*, the relationship of the participants and of the operator is directly with the *Waqf* fund. The operator is the *Wakīl* of the *Waqf* fund, and the participants pay one-sided donations to the *Waqf* fund (not conditional) to become members. This also takes care of the doubt expressed relating to the possibility of a contract of compensation under a typical *Wakālah* model that leads to the issue of *gharar*. In addition to being an agent with the *Waqf*, the company also has the role of *Muḍārib* when it invests the *Waqf* fund.⁶⁹

⁶⁸ Mortuza Ali, K.M. (2006). Basis and models of Takāful: The need for *Ijtihād*, Takāful Articles No: 03, p.3

⁶⁹ Abdul Rahim, A.W., Lewis, M.K. and Kabir Hassan, M. (2007). Islamic Takāful: Business Models, *Sharī'ah* Concerns, and Proposed Solutions, Thunderbird International Business Review, Vol. 49(3) 371–396, p.388

The refinements to the *Wakālah* model discussed here follow in principle the same approach as under a typical *Wakālah* model but with some refinements that address some of the concerns and doubts that *Sharī'ah* scholars have identified. These refinements meet some of the concerns with the *Wakālah* model and at the same time ought not to be difficult to implement.⁷⁰

Finally, Ma'sum Billah⁷¹ noted that each of these models has its own strong and weak points, and none can be distinct from the others as each meets the needs of a particular market. It is difficult to judge the full extent of the merits of each of these models which all serve their purpose in their own way. None of them are perfect, and there must be concerted efforts to fine tune them to solve the problems in each of the models. This is the only way forward to ensure the success of Takāful globally.

Takāful practitioners, *Sharī'ah* experts, and government authorities should have mutual cooperation and understanding to plan strategic solutions. Educating them is the answer. There is a constant debate on the usage of the models, and this is always highlighted when Takāful practitioners come together at conferences. Many have expressed their opinions that the *Sharī'ah* councils should come up with a standard model for international use. However, since different regions have their own laws, having a standard global model may be difficult to implement. Some do not accept certain models that do not agree with their laws. The jury is still out on when and how a standard global model will evolve.

⁷⁰ Abdul Rahim, A.W., Lewis, M.K. and Kabir Hassan, M. (2007).Islamic Takāful: Business Models, *Sharī'ah* Concerns, and Proposed Solutions, Thunderbird International Business Review, Vol. 49(3) 371–396, p.392

⁷¹ Ma'sum Billah, M., Different Models of Takāful in the Global Sound Market, p.16

1.8.6 Surplus

Underwriting surplus has several issues in Takāful insurance. AAOIFI⁷² defines that the surplus comprises of residual premiums of the participants (the insured) in addition to the reserves and profits, after deducting all expenses and indemnity amounts (paid or payable during the same year). The residual amount, thus computed, is considered surplus rather than profit. In other words, the insurance surplus is the remaining amount of money in the insured parties' account. It includes the sum of their paid premiums and their investments after deducting the payments due to them, payment of claims, reinsurance expenses, and paying of fees due to the operator as well as maintaining technical reserves.⁷³

It should be noted that even in a *Wakālah* model, the issue on how to treat the net underwriting surplus remains. Generally, the net underwriting surplus is treated as belonging to the Takāful fund because it originates directly from the fund and the Takāful operator is just a manager and not owner of the fund.⁷⁴ In view of this, AAOIFI *Shari'ah* standard No. 26 (5/5) of 2007⁷⁵ rules that the surplus can only be distributed back to the participants, and cannot be taken by the Takāful operator.

However, some Takāful operators feel they should also get a "share" of the net underwriting surplus even when using a *Wakālah* operational model. Thus, some Takāful operators take specified and agreed portions of the net underwriting surplus on the basis of "performance fee". The underlying argument is the good and expert management of

⁷² AAOIFI (2007). *Shari'ah* Standards for Islamic Financial Institutions, No: 26, p.488

⁷³ Sabbagh, A.M. (2006). Islamic Cooperative Insurance (paper submitted at World Takāful Conference - Dubai UAE April 2006), © 2011 Institute of Islamic Banking and Insurance, p.1

⁷⁴ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp. 50 and 51

⁷⁵ AAOIFI (2007). *Shari'ah* Standards for Islamic Financial Institutions, No: 26, p.473

the Takāful operator (especially in the underwriting of contributions, assessment of risks and claim management) has contributed to the availability of the surplus and thus, they should be rewarded for the good performance. Although, they have been rewarded by way of a defined and agreed upfront management fee, they would like to also enjoy additional income from the net underwriting surplus as incentives.

As a result, a variant form of *Wakālah* arrangement has been introduced, termed by some as ‘modified *Wakālah* model’, as opposed to ‘pure *Wakālah* model’ that does not allow for sharing of net underwriting surplus with the Takāful operator. It should be noted that the so-called ‘modified *Wakālah* model’ is always subject to one important condition, i.e., prior consent of Takāful participants must be obtained before any payment of performance fee or reward can be made to the Takāful operator from net underwriting surplus. This is because the net underwriting surplus is originally the participants’ and can only be taken with their consent and knowledge.⁷⁶

But the *Ijmā’* meeting of over 40 *Sharī’ah* scholars which was organised by *Dārul Uloom*, Karachi including scholars from different institutions in the country as well as from Bangladesh and Abu Ghuodah from Middle East, opposes this idea arguing that sharing in underwriting surplus is something that does not appear to be in line with the concept of mutual assistance and hiring of professional expertise of “Risk Manager” although it may be argued that it is meant to provide an incentive to the operator to “better manage” the risk. One may argue that as a *Wakīl* and trustee the operator is responsible to ensure careful and fair management of the Takāful fund for the fee that it is receiving. Moreover, better underwriting results through careful risk selection and management

⁷⁶ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp. 51 and 52

would ensure that higher surpluses arise in the Takāful fund for distribution to participants. Higher surplus distribution in itself is an incentive for the operator as more clients may get attracted to it due to its better “risk management” capability. This would be an indirect benefit of better management and not a direct one which seems more acceptable given the principles of Takāful and also the concerns relating to the *Muḍārabah* model where underwriting profits are shared. The view of prominent *Sharī’ah* scholars in this regard is that any sharing in surplus by way of an incentive is not permissible.⁷⁷

Regarding the eligibility of participants in the share of the surplus, there are two different approaches. Some are of the opinion that participants will be eligible to participate in the distributable surplus, provided they have not made any claims⁷⁸ or received any Takāful benefits from the operator or if they have surrendered/terminated policies. Others opine that the participants are eligible to the share of surplus if the claim is less than the contribution.⁷⁹ The surplus arising from participants’ funds will usually be distributed to participants and, depending on the Takāful model, also shared with the Takāful operator. The surplus from the risk fund may also be donated to charities underwriting surplus as an incentive for his good performance. This practice is selected by the operator’s *Sharī’ah* advisory board.

In pure *Wakālah* model, the Takāful operator does not share in the underwriting or investment profits. But in the modified *Wakālah* model, he will get a proportional share in the widespread, e.g. approved by National *Sharī’ah* Council of Malaysia and applied

⁷⁷ Abdul Rahim, A.W., Takāful Business Models – *Wakālah* based on *Waqf*, p.6

⁷⁸ Yassin, N., and Ramly, J (2011) Takāful: A Study Guide, p. 125 and Frenz, T. and Soualhi, Y. (2010). (2nd Edition), Takāful & Retakāful – Advanced Principles & Practices, p. 182

⁷⁹ Frenz, T. and Soualhi, Y. (2010). (2nd Edition), Takāful & Retakāful – Advanced Principles & Practices, p. 136

in Indonesia, but not acceptable to all scholars and practitioners for two reasons. One is the operator makes a profit from the underwriting surplus but it is not responsible for losses unlike the participants. Another is that sharing of underwriting surplus originating from the pool of donations is not fair. In the *Mudārabah* model and hybrid *Wakālah-Mudārabah* model, it is essential for the contract to detail how underwriting and investment profits are to be shared between the operator and participants.⁸⁰

It is notable that there should be claims of contingency reserve in Takāful operation built up from underwriting surplus. Any deficit will be charged to the contingency reserve before a *qarḍ ḥasan* is provided. If the underwriting result of the Takāful fund is positive, the reserve will repay any outstanding *qarḍ ḥasan* first.⁸¹ The AAOIFI financial standard⁸² and Pakistan Takāful rules 2005 allow this course of action.

1.8.7 Takāful Policies

Takāful operators offer both general Takāful and family Takāful products as is done by conventional insurance companies. General Takāful (Non-life) is the alternative to general insurance while family Takāful (life) is the alternative to life insurance.

1.8.7.1 General Takāful

There are many products in general Takāful. Motor vehicles Takāful, fire Takāful, miscellaneous Takāful are used in Malaysia. Miscellaneous Takāful contains workman

⁸⁰ Frenz, T. and Soualhi, Y. (2010). (2nd Edition), *Takāful & Retakāful – Advanced Principles & Practices* pp.136-144

⁸¹ Sabbagh, A.M. (2006). Islamic Cooperative Insurance (paper submitted at World *Takāful* Conference - Dubai UAE April 2006), © 2011 Institute of Islamic Banking and Insurance, p.3 and Frenz, T. and Soualhi, Y. (2010). (2nd Edition), *Takāful & Retakāful – Advanced Principles & Practices*, p.178

⁸² AAOIFI (2007). *Shari'ah Standards for Islamic Financial Institutions*, No: 26, p.473

compensation Takāful, personal accident Takāful, fidelity guarantee Takāful, plate glass Takāful, money Takāful, public liability Takāful and bonds Takāful.⁸³ Marine Takāful is a major product and so are theft Takāful, engineering Takāful, aviation Takāful and business Takāful under the miscellaneous Takāful.⁸⁴ Some others consider engineering Takāful as a main Takāful product.⁸⁵

General Takāful contracts are usually made for a period of one year or less and at the end of the period are renewable by mutual consent of the operator and the participant.

1.8.7.2 Family Takāful

Takāful life insurance is named family Takāful or social Takāful. In this type of Takāful insurance, the policy has a defined period of maturity; the insured commonly make periodic level premium contributions that will be used primarily for meeting their individual savings target and in part for assisting financially the bereaved family of another deceased insured. The premium amounts vary from insured to insured depending on the sum (face amount) that each insured targets to accumulate at the end of the coverage period and on the age, gender and health condition of that insured. The insurer may set the minimum face amount for this purpose. It may also set the minimum and maximum age limits for participating in this type of policy, accept standard risks only and maintain separate classes of insured of the same age but with different year of entry to the plan.⁸⁶

⁸³ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). *Essential Guide to Takāful (Islamic Insurance)*, pp.56&57

⁸⁴ Nasser Yassin and Jamil Ramly (2011). *Takāful: A Study Guide*, pp.264 and 265

⁸⁵ Fadzli Yusuf, M., Wan Ismail, W.Z., and Mohamed Naaim, A.K. (2011). *Fundamentals of Takāful*, pp.108 and 109

⁸⁶ Maysami, R.C. and Kwon, W.J., n.d., *An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism*, p.8

Takāful life insurance is also used for other purposes, including generating a fund for children's education, securing a fund in case of mortgagor's premature death and protecting business interest against key-employee's death. Several Takāful policies now come with hospitalisation and disability benefits. In fact, there is virtually a counterpart Takāful life insurance policy for each major type of conventional life insurance policy, while difference lies in how premiums are allocated.⁸⁷

In this regard, there are three types of cover in family Takāful; Individual family Takāful (Individuals), Group family Takāful (employees, clubs, associations and societies) and family Takāful rider is an extension of the basic family Takāful. The rider provides coverage against personal accident and disability, medical and health.⁸⁸

In family Takāful, the participants generally pay the contributions for two main purposes: Firstly, as donations to the Takāful fund to provide mutual indemnity among the participants, secondly, as savings and investments for his or his family's benefits. Because of that, the contributions by the participants in family Takāful are normally credited in to the family Takāful fund which is then split in to two accounts, namely: Participants' special account (PSA), which is the donation or risk account. Participants' account (PA), which is the savings and investments account.⁸⁹

Family Takāful in Malaysia can be divided into two main plans; individual plan and mortgage plan. Under the individual plan, the benefits are generally as follows: upon maturity of certificate, the participant shall receive the amount accumulated in the

⁸⁷ Maysami, R.C. and Kwon, W.J., n.d., An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism, p.8

⁸⁸ Nasser Yassin and Jamil Ramly (2011). Takāful: A Study Guide, pp.320 and 321

⁸⁹ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp.67&68

participants' account with the proportionate surplus, if any, arising from the participants' special account.⁹⁰

1.8.8 Takāful Industry in Sri Lanka

The Democratic Socialist Republic of Sri Lanka (formerly known as Ceylon), an island in the Indian Ocean, is situated 28 kilometres off the south eastern coast of India. Sri Lanka is famous for its; golden beaches, gem stones, top quality tea, national cricket team, beautiful and dense forests.

Sri Lanka is ethnically, linguistically, and religiously diverse. Of the country's population of about 20 million, Buddhists represent 70% and are concentrated in the southern and south western parts of the island. Hindus constitute about 12.6% of the population, whose South Indian ancestors have lived in the island for centuries, are living predominantly in Northern, Eastern Provinces and in the central hills as Plantation Tamils, a distinct ethnic group, brought from South India by the colonial British to work in tea estates. Of other minorities, Muslims (both Moors and Malays) constitute 9.7% of the population and Roman Catholics and other Christians represent 7.4%.⁹¹

The insurance industry has been operating in Sri Lanka for more than 50 years. However, the Takāful business model only started 16 years ago with the first establishment of Amana Takāful in 1999. Naturally, there are both conventional and Takāful companies in Sri Lanka. Both types offer a wide range of non-life and life

⁹⁰ Engku Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p.68

⁹¹Department of Census and Statistics – Sri Lanka (2011), accessed through <http://www.statistics.gov.lk/PopHouSat/CPH2011/index.php?fileName=pop33&gp=Activities&tpl=3> On 6 November 2012

insurance products. At present, there are 22 insurance companies registered under the Regulation of Insurance Industry Act, no. 43 of 2000 as at 31 December 2014 among them the Ceylinco Takāful which is prohibited from engaging insurance business since 5 August 2009 and there are 58 insurance broking companies registered under the same regulatory act.⁹²

It is notable that there is little literature on the Takāful industry in Sri Lanka. No one has so far conducted a systematic research in this field. Some practitioners like Zaheed and Mohideen wrote on initiatives, developments and potentials of Takāful business in Sri Lanka. This will be further elaborated in chapter four.

1.8.8.1 Amana Takāful PLC

Zaheed,⁹³ former director and CEO of Amana Takāful, elaborates about the Takāful industry in Sri Lanka especially Amana Takāful PLC. In brief, he explains about the origin and growth of Amana Takāful in Sri Lanka, its technical assistance from *Syarikat* Takāful Malaysia, its challenges, its branches within Sri Lanka and abroad, and the acceptance of Takāful by non-Muslim majority of Sri Lanka and its potential to become the largest Takāful hub in South Asia.

⁹² Insurance Board of Sri Lanka, Annual Report, 2014, p. 22

⁹³ Ehsan Zaheed (2010). Sri Lanka: A potential Regional Hub for Takāful, pp.71 and 72

1.8.8.2 Ceylinco Takāful Ltd.

Mohideen,⁹⁴ who is a chartered insurer and was general manager, Ceylinco Takāful Ltd. detailed the emergence of the Takāful industry in Sri Lanka, origin and growth of Ceylinco Takāful Ltd, its objectives and importance of insurance for Muslims of Sri Lanka. However, Ceylinco Takāful Ltd. has been prohibited from engaging in insurance activities by Insurance Board of Sri Lanka since 5 August 2009. It is also a researchable theme in the context of Sri Lanka on the causes and effects of its closure.

1.8.9 Challenges of the Takāful Industry

There are challenges facing the entire Takāful industry. Some challenges are specific to a particular country or region on the basis of minority, political situation, cultural aspects etc. If we look at the challenges of the Takāful industry internationally, according to the world Takāful report – 2011 there are six main themes of challenges or risks: competition, shortage of expertise, socio-political uncertainty, evolving regulation, misaligned cost, and inability to achieve underwriting profit.⁹⁵

There are several issues that need to be resolved before Takāful insurance can advance globally. First, there is a need to educate the public about insurance. Second, the majority Takāful insurers currently operate only in their local market. They need to expose themselves to the international insurance market. Third, there is no general agreement on the need for Takāful insurance. Some have doubts about the need for a separate insurance system based solely on religion, while others question the

⁹⁴ Mohideen, S.A.H. (2007). Sri Lanka: Lessons and Tips from A Driven Takāful Newcomer, Emerging Asian Markets in Takāful: Pakistan, Sri Lanka and Thailand – The Tide is Swelling, p.71

⁹⁵ The world Takāful report – 2011, Dubai, UAE: MEGA Brands, p.45

competitiveness of Takāful insurance. Fourth, Takāful insurance is, on one hand, a profit sharing arrangement between an insurer and its insured. Takāful insurers are expected to exercise prudence in making investment decisions and not to subject such funds to potentially high return and high risk situations. On the other hand, the Takāful insured would prefer those Takāful funds to generate higher return than other Takāful funds. Finally, there must be a formal supervisory system that monitors Takāful operations efficiently. The mere existence of a *Shari'ah* supervisory board within a Takāful insurer may not be effective in this regard.⁹⁶

When a participant enters into a Takāful scheme, he is not expected to have any intention of making money. His intention would be to share his wealth via contributing money or giving his money as *tabarru'* towards a fund that is used to help another person in the event of a financial crisis. He should look beyond worldly rewards and be rest assured that when his time comes to face death, the Takāful operator who manages the fund shall also ease the burden of his family in the same way it was done to ease the burden of others who have died earlier.

However, in actual practice, that is not the case. When participants are coaxed by agents to participate in the scheme, they are usually promised a certain benefit amount and percentage of surplus as well as investment returns.⁹⁷

Another important factor of the Takāful industry is that most of our management professionals in Takāful are brought from conventional insurance companies. In the majority of cases, their mindset is more tuned with the conventional system. Top

⁹⁶ Maysami, R.C. and Kwon, W.J., n.d., An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism, pp.19 and 20

⁹⁷ Roslinah, D. (2009). Underwriting Family Takāful Schemes, Takāful Articles No: 18, p.2

management and executives of Takāful operators must be fit, proper, honest, competent and capable to comply with *Shari'ah*, regulatory, legal, accounting and underwriting matters. Furthermore, they ought to be committed and courageous to go ahead with the principles of the Takāful system for the betterment of their customers and all the stakeholders.⁹⁸

Swiss Re describes three factors of major challenges. Sustained growth over the longer term and an extension of Takāful beyond the Muslim countries will require key issues to be addressed. First, consumer awareness and product development are important even in the most advanced markets, not only for Takāful but also for the concept of insurance in general.

Second, for a truly global Takāful sector to develop, the industry needs a higher degree of standardisation in terms of business models and regulation, particularly in developed countries with multicultural Muslim populations or even with non-Muslims.

Finally, the success of Takāful depends on developed and deep Islamic financial markets with a broad range of investment opportunities. A large primary market with Islamic bonds (*Sukūk*) but also a liquid secondary market is important for Takāful companies to efficiently match assets to liabilities and earn attractive investment returns for policyholders.⁹⁹

On the other hand, the Takāful operators in non-Muslim countries face their unique problems and challenges. For instance, the *halāl* investments procedures and

⁹⁸ Mortuza Ali, K.M. (2010). Critical Issues and success factors for Takāful, Takāful Articles No: 21, p.2

⁹⁹ Daniel Staib (2011). Islamic Insurance Revisited, p.4

opportunities under a regulatory manner is one of the major challenges faced by the Takāful companies in non-Muslim countries. By contrast, Takāful operators in Muslim countries have no such problem.¹⁰⁰

Mohideen¹⁰¹ explains the main challenges of Takāful in the Sri Lankan context as follows:

“The successful operations of Takāful require a proper mix of insurance technical knowhow and *Sharī’ah* knowledge. But in reality these two fields of study remain far apart, and it is, indeed, a challenge to achieve the proper mix. A person who is well-versed in both fields is a rare commodity. As a result, the Takāful concept has been vaguely understood and loosely practiced. Unfortunately, the concept of Takāful has been misunderstood. A strong religious flavour has been attached to Takāful; resulting in widespread belief that Takāful is for Muslims only. Eradicating this fallacy and creating the right mindset favourable to Takāful is an urgent necessity. Carrying out an intensive and effective awareness campaign requires a huge budget which a new Takāful company with limited resources could hardly afford.”

The existing legal framework places Takāful companies in a handicapped position compared to conventional insurers. The present set of regulations, evolved over a period of time, was intended to regulate conventional insurers, but the same set is being used to regulate Takāful companies as well. This deprives Takāful companies of a level playing field.

Various restrictions laid by insurance regulators on the choice of investment avenues for the insurance fund serve only to add to the burdens of a Takāful company. The dearth of *Sharī’ah* compliant investment opportunities in Sri Lanka is another hurdle. Thus, Takāful companies are left with limited investment choices.¹⁰²

¹⁰⁰ Maysami, R.C. and Kwon, W.J., n.d., An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism, pp.15 and 16

¹⁰¹ Mohideen, S.A.H., 2007, Sri Lanka: Lessons and Tips from A Driven Takāful Newcomer, Emerging Asian Markets in Takāful: Pakistan, Sri Lanka and Thailand – The Tide is Swelling, pp.71 and 72

¹⁰² *Ibid*, pp.71 and 72

Zaheed¹⁰³ emphasises the above two challenges as the key challenges for the Takāful and Islamic financial industry in Sri Lanka.

At present, Takāful operations, to a large extent, follow those of conventional insurance because the management team comprises persons recruited from conventional insurance companies, and these persons have little or no knowledge of *Sharī'ah* aspects of Takāful. A quick transformation from conventional culture to Takāful culture and adherence to Islamic values is of paramount importance if the true spirit of Takāful were to be preserved.

The purity of Takāful is at stake unless and until risks are fully covered by retakāful arrangements backed by very strong retakāful companies. Due to the dearth of strong retakāful players acceptable to the regulators, Takāful companies have no alternative but to seek support from the conventional reinsurance market.

We believe that Islamic *Sharī'ah* is capable and versatile of facing any challenge in any dimension of social life if we use it in a correct way. We have to use the tools of *Fiqh al-Aqalliyāt*¹⁰⁴ (فقه الأقليات) to solve problems we face when we live as minorities. As an illustration, Muslims who live in most countries in Europe use this tool quite effectively. The European Council for *Fatwa* and Research (ECFR) is a Dublin-based

¹⁰³ Ehsan Zaheed (2010). Sri Lanka: A potential Regional Hub for Takāful, pp.71 and 72

¹⁰⁴ *Fiqh al-Aqalliyāt*—the jurisprudence of Muslim minorities—is a legal doctrine asserting that Muslim minorities, especially those residing in the West, deserve a special new legal discipline to address their unique religious needs that differ from those of Muslims residing in Islamic countries. It was introduced in the 1990s by two prominent Muslim religious figures, Shaykh Dr. Taha Jabir al-Alwani of Virginia, and Shaykh Dr. Yusuf al-Qaradawi of Qatar. Developed as a means of assisting Muslim minorities in the West in practicing their faith, it deals with the problems Muslims face in countries where they are minorities (including India) and focuses more on special and exceptional rulings for those special circumstances. Tauseef Ahmad Parray, “*The Legal Methodology of ‘Fiqh al-Aqalliyāt’ and its Critics: An Analytical Study*,” *Journal of Muslim Minority Affairs*, Vol. 32, No. 1, March 2012, p. 88.

private foundation, founded in London on 29–30 March 1997 on the initiative of the Federation of Islamic Organisations in Europe. The Council is a largely self-selected body, composed of Islamic clerics and scholars, presided over by Al-Qaradāwi. One of its main aims is to unify the jurisprudential views with the main fiqh (Islamic law) issues, especially with regard to the minority status of Muslims in Europe.¹⁰⁵

As Ali contends, commercial transactions are constantly developing from one generation to another to meet the needs of society. It also varies from country to country. Market practices are different. There are also differences in rules, regulations and laws of commercial and financial transactions. Variations and changes are unavoidable and Islamic law does not resist changes taking place in the commercial environment. Therefore, various models and systems under the *Sharī'ah* framework ought to respond to these changes to sustain the relevance of Islamic law, throughout the centuries. *Ijtihād* (الاجتهاد) has been an everlasting tool for Islamic dynamism. Modern Islamic jurists need to exercise their independent legal reasoning to formulate new ideas and alternatives for the growth and survival of Islamic insurance system in the contemporary world.¹⁰⁶

¹⁰⁵ http://en.wikipedia.org/wiki/European_Council_for_Fatwa_and_Research

¹⁰⁶ Mortuza Ali, K.M. (2006). Basis and models of Takāful: The need for *Ijtihād*, Takāful, Articles No: 03, p.5

1.9 Outline of Chapters

Chapter 1: Introduction of the Study

Chapter one offers a short background and overview, statement of the problem, the research questions, scope of the study, objective of the study, and significance of the study. It also contains the method of the study, population, sample, tools, procedures, and tools of analysis. Literature review is also an essential component of a research. This chapter encompasses the in-depth analysis of related literature.

Chapter 2: Sri Lanka and Its Insurance Regulators

This chapter briefly introduces Sri Lanka and its insurance regulators to give a clear picture of the ground situation of the research. It analyses the political, economic, and social systems of Sri Lanka and the history of insurance in Sri Lanka. It also specifies the regulatory authorities for insurance in Sri Lanka, Central Bank of Sri Lanka (CBSL) and Insurance Board of Sri Lanka (IBSL).

Chapter 3: Takāful - Developments and Challenges

The third chapter explores in detail the Islamic insurance or Takāful. It provides a comprehensive analysis of the subject. This chapter focuses on the developments and challenges of Takāful. The section on the development of Takāful deals with Islamic insurance (Takāful), its definition, its history, its importance and significance, developments of Takāful, its spread and growth, its policies/products, its models, its contracts, Takāful windows, retakāful, bancatakāful, regulation and governance and

investment. The section on challenges of Takāful embodies lack of public awareness, shortage of expertise and skilled staff, regulatory challenges, marketing challenges and other challenges.

Chapter 4: Developments of Takāful in Sri Lanka

In this chapter, developments of Takāful in Sri Lanka are discoursed under Takāful companies in Sri Lanka and developments of Takāful in Sri Lanka. The segment of Takāful companies in Sri Lanka gives an account of Amana Takāful PLC, Ceylinco Takāful Ltd. and HNB Assurance Takāful, while the segment of developments of Takāful in Sri Lanka analyses jurisprudential developments and business developments. Takāful models and Takāful standards are also discussed in the jurisprudential developments. Further, growth, products, investments, participants, staff, branches, retakāful, education, training and research, bancatakāful, CSR programmes and Takāful Window are examined.

Chapter 5: Challenges of Takāful in Sri Lanka

Chapter five deliberates on the challenges of Takāful in Sri Lanka. It deals with the lack of public awareness, the lack of expertise and trained staff, regulatory challenges, conventional insurance companies, investment oriented challenges, marketing challenges, retakāful related challenges and other challenges.

Chapter 6: Findings, Suggestions and Conclusion

This final chapter is divided into three main segments. The first segment sums up four main themes namely, *Shari'ah* compliancy, developments, challenges, and potentiality. The segment of suggestions explain about an institution for Takāful, books and journals, legal framework for Takāful, increase of competitors, inclusion of Takāful in formal education and madrasah curriculum, establishment of propaganda unit, establishment of economic and financial research unit, intellectual and spiritual training, plan to produce *Shari'ah* scholars, experts in Takāful, an apex body for *Shari'ah* supervision, good marketing strategies and introducing new products. Conclusion is the third segment of this chapter.

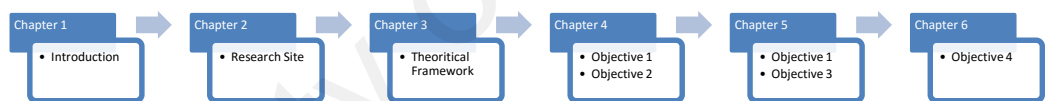


Figure 1.2: Objectives and Chapters

CHAPTER 2: SRI LANKA AND ITS INSURANCE REGULATORS

2.1 Introduction

This chapter concentrates on two major parts. One is Sri Lanka in brief as the country where this research was conducted. The second part discusses the insurance regulators of Sri Lanka because Takāful is also bound to operate according to the regulations which are applicable to the conventional insurance companies.

2.2 A Brief Introduction to Sri Lanka



Figure 2.1: Location of Sri Lanka in Indian Ocean

The Democratic Socialist Republic of Sri Lanka (formerly known as Ceylon), an island about the size of Tasmania in the Indian Ocean, is located about 28 kilometres off

the south eastern coast of India. It is a 65,610 square–km (25,332 square mile) teardrop off the southeast tip of the Indian subcontinent. It is separated from the continent by the Palk Strait and Gulf of Mannar, but a chain of islands and sand bars known as Adam’s Bridge links them. It is about 400 km (273 miles) in length and about 220 km (137 miles) at its widest point. The centre of the island is mountainous.¹⁰⁷ Sri Lanka is famous for its golden beaches, gem stones, top quality tea, national cricket team, beautiful and dense forests. There is little seasonal variation in temperatures. Lowland temperatures average 28 degrees C (82 degrees F) year round, with higher temperatures in the north central plains. The temperature in the highlands varies with the elevation; towns at higher elevations have average high temperatures of 20 degrees C (68 degrees F) and lows of 10 degrees C (50 degrees F).¹⁰⁸ Sri Lanka is mainly an agricultural country. It is self-sufficient in its staple diet rice which is the largest cultivation. Tea, Coconut and Rubber are the main economic agricultural crops. Tea brings beauty as well as the foreign exchange to the country.

The people of Sri Lanka are grouped into a number of ethnic identities, which are rooted in the early history of the island but took their current form in the nineteenth and twentieth centuries. The small community of *Veddas* is popularly believed to be the descendants of the aboriginal population of the island. The Sinhalese and “Ceylon Tamils” (about 12.6% of the population of 20 million) claim descent from Indian settlers more than 2,000 years ago. The “Ceylon Moors” (7.1% of the population) are Muslims who trace their origins to seafaring Arab merchants. Other ethnic communities originated during the colonial era. Tamil-speaking immigrants from South India were known as “Indian Tamils” or “Indian Moors” (if Muslim) by the British rulers. Muslims of recent

¹⁰⁷ Patrick Peebles (2006). *The History of Sri Lanka*, p. 2

¹⁰⁸ *Ibid*, p. 2

Indian origin, primarily merchants, have assimilated to the larger Muslim community, but the descendants of Indians who immigrated from India as plantation workers survive as an ethnic group known as “Plantation community” or “Up-Country Tamils” (about 5.6 percent of the total population); Malays descended from Southeast Asian immigrants during the colonial era; and Burghers are descendants of European settlers. The latter two groups number only a few tens of thousands.¹⁰⁹

Sinhala is the mother tongue of three-fourths of the people of Sri Lanka; it is related to Indo-European languages of north India. Most of the remainder of the population speak Tamil, from the Dravidian family of languages. There are also descendants of Malay immigrants who speak Malay. A significant number of Sri Lankans of all communities use English as the first language.¹¹⁰ Both Sinhala and Tamil are official languages.¹¹¹

Muslims live scattered all over the island among the other two communities, except in the south eastern part of the country, where Muslims live as a majority in certain pockets. Muslims have traditionally depended on commerce over the last many decades and thus ignored the importance of education.

Historically, Sri Lanka was an advanced kingdom with strong focus on agriculture. An elaborate network of irrigated rice cultivation flourished in the north central plains of the island for a millennium. Its major contribution to civilisation was the preservation of an early form of the teachings of the Buddha while Hinduism displaced Buddhism in India. The ancient kingdom went into decline a thousand years ago and

¹⁰⁹ Patrick Peebles (2006). *The History of Sri Lanka*, p. 7

¹¹⁰ *Ibid*, p. 6

¹¹¹ *Ibid*, p. 7

disappeared through fragmentation, foreign conquest, and endemic malaria. A succession of weak royal successors faced European colonialism, beginning with the Portuguese in 1505 and culminating in the British conquest of the entire island in 1815. Since independence in 1948, it has remained a democracy but has been unable to create a stable and prosperous society.¹¹²

Since 2001, Sri Lanka has sought closer ties with the U.S., though traditionally the country follows a non-aligned foreign policy and was a founder member of the Non-Aligned Movement (NAM). Sri Lanka is also a member of the South Asian Association for Regional Cooperation (SAARC) and is affiliated to the World Bank, International Monetary Fund, Asian Development Bank, and is a member of the Commonwealth.

From mid-1983 Sri Lanka was affected by a civil conflicts based on demands by the Tamil community for the establishment of a separate state for Northern and Eastern Tamils. The situation degenerated into armed conflict with Tamil youth opting for militancy. Government forces were compelled to confront the Tamil rebel groups who took arms against the government. The dominant rebel group, the Liberation Tigers of Tamil Eelam (LTTE) became powerful and actively confronted government forces. The LTTE eliminated smaller rebel groups which were operating with the same motive, and became a large, strong and ruthless group which pooled support resources nationally and internationally. The confrontation lasted more than two decades and culminated with North and a major portion of Eastern area under the control of LTTE.

By April 2009, the Sri Lankan Government had reclaimed all areas that were under LTTE control except for a small area of land on the north-east coast. On 18 May

¹¹² Patrick Peebles (2006). *The History of Sri Lanka*, pp. 1 and 2

2009, the Sri Lankan Government formally announced its military victory over the LTTE and regained complete territorial control over Sri Lanka. Over the course of the 26 years of confrontation between government and the LTTE rebels, tens of thousands of people were killed and hundreds of thousands of people were displaced.

In March 2012, the UN Human Rights Council adopted a resolution calling on Sri Lanka to address alleged violations of human rights during the final stages of the war and to implement the LLRC¹¹³ report's constructive recommendations, and to present a comprehensive action plan on implementing the recommendations.

The Sri Lankan government released a National Action Plan to implement the recommendations of the LLRC report on 26 July 2012. Sri Lanka's progress on human rights was reviewed by the UN Human Rights Council at Sri Lanka's second Universal Periodic Review on 1 November 2012.¹¹⁴

In March 2014, the United Nations Human Rights Council voted to open an international investigation into possible war crimes by both the armed forces of the Sri Lanka government and the Tamil Tiger rebels in the final stage of a 26-year civil war that ended in 2009.

¹¹³ Lessons Learnt and Reconciliation Commission. In May 2010, President Rajapaksa appointed a Lessons Learnt and Reconciliation Commission (LLRC) to investigate events from February 2002 to the end of the conflict in May 2009 and report whether any person, group or institution bore responsibility for those events and to make recommendations to prevent a recurrence of conflict and regarding restitution. The final LLRC report, tabled in Sri Lanka's Parliament on 16 December 2011, recommended advancing reconciliation and reconstruction, including through reducing the presence of security forces in the north, care of internally displaced persons and enhanced media freedoms.

¹¹⁴ For detail: Country Brief, Dept. of Foreign Affairs and Trade, Australian Government, retrieved from http://www.dfat.gov.au/geo/sri_lanka/sri_lanka_country_brief.html accessed on 20 May 2013

2.3 Political, Economic and Social System of Sri Lanka

It is an accepted fact that the general lifestyle of people in any country is strongly influenced by the economic, political and social environment of the country. Most developing countries experience political uncertainty which is a serious hindrance to sustain a stable economic policy.

The political uncertainty in Sri Lanka is mild, but it influences the lifestyle of the people in many ways. People prefer a stable government with realistic and firm development policies which are sustainable over a long period of time. This ensures social and economic prosperity to all citizens.

For an insurance industry to develop in any country, there has to exist within the hearts and minds of people, a strong conviction that policy holders will become beneficiaries and will be protected from insurable risks in accordance to the policies that they purchase. It is the political environment and economic policies of the country, which must create the environment and climate that will assure people of economic stability.

The growth or decline of the insurance industry therefore depends on the political, economic and social environment.

2.3.1 Political Overview

Political stability and good governance lead a country to development and prosperity. In a democratic country, governments in power enact legislation through parliament which is made up of members who represent the people. The political process

in the Democratic Socialist Republic of Sri Lanka since independence in 1948 has been hall marked by a commitment to the democratic way of governance. Power has fluctuated between two main political parties, i.e. the leftist Sri Lanka Freedom Party (SLFP) and the centre-right United National Party (UNP). The SLFP is the major party in the present United People's Freedom Alliance (UPFA, formerly known as People's Alliance) coalition of President Mahinda Rajapaksa. The President is both the Head of State and Head of Government.¹¹⁵

In the presidential election held on 8th January 2015, the current president Maithripala Sirisena won an unexpected victory, defeating the former president Mahinda Rajapakse. Mr. Sirisena formed a government with the support of the United National Party (UNP) and in March 2015, formed a national coalition government by including members of the Sri Lanka Freedom Party (SLFP). The president thereafter announced a '100-day programme' as per his election manifesto, promising good governance as the core issue.¹¹⁶ After the August 17th 2015 general election, Mr. Wicramasinghe, who leads the largest party in parliament, was sworn in as Prime Minister. The two biggest parties, President Sirisena's SLFP and Prime Minister Wickremesingha's UNP agreed to form a national unity government committed to ethnic reconciliation and to uphold the rights of minorities. This new political development ushered for the first time in Sri Lanka a situation of political stability with scope for economic wellbeing and growth. This also created opportunities for innovative systems of finance to grow and take root in the country including Takāful.

¹¹⁵ Country Brief, Dept. of Foreign Affairs and Trade, Australian Government, retrieved from http://www.dfat.gov.au/geo/sri_lanka/sri_lanka_country_brief.html accessed on 20 May 2013

¹¹⁶ Wijayalath, A.K. (2015) Sri Lanka: Towards the 'National Purpose', ISAS Insights (296), p. 4

2.3.2 Economic Overview

The type of governance a country adopts to a very large extent determines its economic policy and related matters. Some countries choosing the approach of central planning follow the principles of Communism. There are clear differences between countries that are ruled according to communist principles and countries governed by free enterprise capitalist philosophy. The insurance industry of the country is strongly influenced depending on the political system and economic policies adopted by the country. According to Wimal Wickramasinghe,¹¹⁷ economic variables bear on the insurable interest, expansion of insurance, insurance penetration, rates of premiums, etc. they are also influenced by economic policy, population size, life expectancy, literacy rate, GDP growth, per capita income, living standards, cost of living and inflation, active labour force, unemployment, poverty, money supply, interest rate, balance of payment outturn, foreign exchange reserves, rate of exchange, education, health, etc. The implementation and success of life insurance policies (flexible, investment, endowment, loan protection and group policies) and general insurance policies (fire, motor, marine and miscellaneous) dependent upon the performance of some or all of the economic variables mentioned above. Even the introduction of micro-insurance in Sri Lanka (or elsewhere) is a response to the existence of significant low income and poor segments in society. Though export credit insurance, agricultural insurance and social security are under state monopoly, their success is dependent upon these economic variables.

Sri Lanka's economic policies have been influenced by various approaches to growth and stability. The colonial economy that Sri Lanka inherited at independence was mostly based on agriculture, either as food for domestic consumption or as production for

¹¹⁷ Wimal, W. (2008). 'Situation Essays' on Insurance in Sri Lanka, p. 12

commercial export. The UNP (United National Party) governments until 1956 made little change to this policy. In that year, the SLFP (Sri Lanka Freedom Party) emphasised industrialisation and manufacturing for domestic consumption through state corporations. The UNP 1965-1970 encouraged the production of food crops. In 1970, a socialist United Front (UF) government nationalised land and industries, restricted foreign investment, and redistributed land to landless peasants for cultivation.

The changes in economic policy during the period of 1965 to 1977 by successive governments changed the economic profile of the country.

These moves led to self-sufficiency in food, especially in rice production and subsidiary crops. At the same time there was a remarkable increase in income oriented manufacturing in industries and the application of 'value added' concept to industrial production boosted the nation's economy.

The diversification of the economy into non-traditional fields generated more income even at grass root levels and helped to bridge income disparities. This development in the country's economy attracted much needed foreign investment.

The tourism industry, garment exports and the growth of medium level industries generated inflow of foreign exchange to the country in addition to earnings through traditional exports like tea, rubber, spices etc. Remittances from Sri Lankans employed abroad have also become a major income source to the country. Every time the right of centre UNP was elected to power, it actively turned the country to an export-oriented market economy, privatising government corporations and encouraging foreign

investment. These policies have continued for years despite the several changes in elected governments.¹¹⁸

Although the country is primarily agricultural (the main crop rice on which there is near self-sufficiency), its major sources of income are mainly on the manufacture and export of garments, Remittances from Sri Lankans working overseas, on the production and export of tea, and on tourism. The emphasis in recent years has been to diversify by increasing the export of manufactured goods and to export agriculture commodities in processed forms.¹¹⁹

Sri Lanka is a lower-middle income developing nation with a GDP of approximately \$50 billion (official exchange rate). This translates into a per capita income of \$5,100 (purchasing power parity). Sri Lanka's 91% literacy rate in local languages and life expectancy of 75 years rank well above those of India, Bangladesh, and Pakistan and compare to those of developed countries. In terms of per capita income, literacy and healthcare, Sri Lanka is ahead of most other countries in the region on most development criteria.¹²⁰ English language ability is relatively high, but has declined significantly since the 1970s.¹²¹

Sri Lanka's income inequality is severe, with striking differences between rural and urban areas. About 15% of the country's population remains impoverished. The impact of 26 years of civil conflict, diminished agricultural labour productivity, lack of

¹¹⁸ Patrick Peebles (2006). *The History of Sri Lanka*, USA: Greenwood Publishing Group, p. 10

¹¹⁹ Royston Ellis (2011). *Sri Lanka* (4th Edition), Bucks, England: Bradt Travel Guides Ltd., p. 9

¹²⁰ Athukorala, Prema-chandra and Jayasuriya, S. (1994). *Macroeconomic Policies, Crises and Growth in Sri Lanka, 1969-90*, p. 2

¹²¹ Country Brief, Dept. of Foreign Affairs and Trade, Australian Government, retrieved from http://www.dfat.gov.au/geo/sri_lanka/sri_lanka_country_brief.html accessed on 20 May 2013

income-earning opportunities for the rural population, high inflation, and poor infrastructure outside the Western Province were impediments to poverty reduction. There are reports that poverty has been decreasing significantly in the last few years.¹²²

Sri Lanka, a contracting party to the General Agreement on Tariffs and Trade (GATT) from 1948, ratified the Marrakesh Agreement in June 1994 to become a founding member of the World Trade Organisation (WTO). The country historically has been one of the driving forces for trade liberalisation in the region and is particularly active in the South Asian Association for Regional Cooperation (SAARC). In 1998, Sri Lanka signed a free trade agreement (FTA) with India, the first stage of which came into force in February 2000. Sri Lanka is one of a number of countries that have expressed an interest in joining APEC (Asia-Pacific Economic Cooperation).¹²³

On December 26, 2004, Sri Lanka was struck by one of history's greatest natural disasters, the tsunami that inundated three-fourths of the island's coastline and killed more than 35,000 people. Nearly a million people were made homeless.¹²⁴ Around 65% of the country's fishing fleet of 29,700 boats was either damaged or destroyed. The tsunami affected economy drastically declined, particularly in the fishing, hotels and restaurants, banking, small industry, domestic trade and transport sectors. The Sri Lankan Government's Reconstruction Strategy has estimated the total recovery cost to be US\$2.2 billion.¹²⁵

¹²²Country Brief, Dept. of Foreign Affairs and Trade, Australian Government, retrieved from http://www.dfat.gov.au/geo/sri_lanka/sri_lanka_country_brief.html accessed on 20 May 2013

¹²³ *Ibid*, accessed on 20 May 2013

¹²⁴ Patrick Peebles (2006). *The History of Sri Lanka*, USA: Greenwood Publishing Group, p. 12

¹²⁵Country Brief, Dept. of Foreign Affairs and Trade, Australian Government, retrieved from http://www.dfat.gov.au/geo/sri_lanka/sri_lanka_country_brief.html accessed on 20 May 2013

The brutal ethnic conflict which erupted in 1983, between majority Sinhalese and the minority Tamils and the tsunami in 2004 devastated the economic growth in Sri Lanka for decades. Due to the global recession and the escalation of violence during the final stages of ethnic war, growth of GDP declined 3.5% in 2009 and the foreign reserves depleted sharply.

Economic recovery bounced back quickly at the end of war and the agreement with the International Monetary Fund (IMF) in July 2009 with follow up assistance Sri Lanka recorded a strong growth in 2010, as GDP recorded a steep upward trend of 8%. Official foreign reserves, including borrowings, reached \$6.6 billion (5.9 months of imports). The post-war economic re-integration of northern and Eastern provinces has boosted agriculture and fisheries, although a large area of agricultural land was damaged by floods in early 2011. Reconstruction of the war-damaged areas as well as infrastructure development throughout the country is also fuelling growth. Tourism has rebounded strongly to a record level. Exports grew by a healthy 17% in 2010. Foreign remittance inflows from Sri Lankans working abroad swelled to \$4.1 billion in 2010 from \$3.3 billion in 2009. The Colombo Stock Exchange was the second-best performing market for the second year in a row. Inflation, which had reached double digit levels during the war years, was around 7% in 2010. Inflation pressures are building, and inflation reached 8.6% in March 2011. Foreign direct investment (FDI) remained relatively low in 2010 at about \$450 million. The FDI target for 2011 is \$1 billion, including investments in the tourism sector.¹²⁶

¹²⁶Global EDGE report, Michigan State University, retrieved from <http://globaledge.msu.edu/countries/sri-lanka/economy> on 19 May 2014

2.3.3 Social Conditions

Socio/economic conditions of a country are generally influenced by the political and economic policies which prevail. The insurance industry is also influenced by the same forces.

Sri Lanka is far ahead of her South Asian neighbours in the accomplishment of human development goals. Life expectancy at birth is currently 72 years and is close to the estimated life span in the developed countries. High literacy rates, low mortality rates and the steadily declining population growth, reflect the country's progress in the sphere of social development. All these human development indicators are a tribute to Sri Lanka's social service network, which was established in the latter part of 1940, ensuring sound educational policies, an extensive health care programme and an effective medical system for all sectors of the nation.¹²⁷

A drastic reduction in demographic indicators such as crude birth rate, crude death rate, fertility rate, maternal mortality rate, infant mortality rate and child death rate has been recorded within the past four decades. The average lifespan has risen steadily, lengthening by 30 years. within the past five decades, thus reflecting the tremendous progress achieved in the health standards of the population.¹²⁸

The granting of free education facilities to the entire population has advanced literacy levels, and given an opportunity for both the rich and the poor alike to pursue higher education. The mid-day meal programme and supply of free school books and

¹²⁷ Review Report (2012). Department of Census and Statistics of Sri Lanka, p. 1

¹²⁸ *Ibid*, pp. 1 and 2

uniforms for school children, are the most recent programmes launched by the Government to further enhance the welfare package, implemented to improve the quality of education in the country.¹²⁹

Sri Lanka also faces some major social problems, i.e. malnutrition, addiction to liquor, drugs, and suicide. The above situation leads to death of individuals or prolonged diseases which both of them effect the family economically which is he/she belongs to. In this nature, insurance policies are very much needed to safe guard the family structure. Otherwise, it will aggravate the society and the country.

Malnutrition among the younger generation continues to be a serious health issue, and a social problem in Sri Lanka. Energy protein malnutrition causing stunting and wasting is the most common ailment observed among the young. The high prevalence of anaemia especially among pregnant women is a serious nutritional problem, affecting both the mother and the unborn baby.¹³⁰

Addiction to liquor and drugs has been identified as a serious health issue and a social menace today. It is seen as the major cause for the eroding human values in modern society of Sri Lanka. Statistics illustrate the rapidly increasing trend of convicted prisoners for offences related to narcotic drugs in the past two decades. An alarming 20 fold increase is registered over a span of 23 years, according to records maintained by the Department of Prisons.¹³¹

¹²⁹ Review Report (2012). Department of Census and Statistics of Sri Lanka, p. 5

¹³⁰ *Ibid*, p. 10

¹³¹ *Ibid*, p. 12

Sri Lanka ranks first among South-East Asian countries with respect to commitment for reduction of suicide. Poverty, destructive pastimes and inability to cope up with stressful situations, which are the main causes leading to the sudden ending of human life in tragic ways.¹³²

Regarding the health issues in Sri Lanka, the following official statistics show how they affect health of citizens. 346 cases of dengue fever were registered in 1997. In 2012 the dengue fever cases increased to 44,461 cases.¹³³ A total number of 9343 cases of all forms of Tuberculosis (TB) was reported in 2012. In 1998 there were 7394 TB cases in the island.¹³⁴ There were 17,642 new persons registered in the government sexually transmitted diseases clinics in 2012 and of them 53% of clinic attendees were diagnosed having at least one sexually transmitted infection.¹³⁵ Incidents of cancer in Sri Lanka were 5,012 in 1985 and 13,635 in 2007. 26,303 patients were newly registered at government cancer units in 2012.¹³⁶ According to the Ministry of Health, approximately 20 people are dying daily in Sri Lanka due to heart diseases which translates into 7,300 deaths per year. 20% of Sri Lanka population suffers from malnutrition, 15% suffer from diabetes and nearly 20% are prone to high blood pressure, noting that such non-communicable diseases are spreading rapidly in the country due to unhealthy food consumed by the public.¹³⁷

The above statistics insist the need of medical insurance / Takāful for the current health situation. It is an opportunity for Takāful operators to develop Takāful policies to suit the needs of the country.

¹³² Review Report (2012). Department of Census and Statistics of Sri Lanka, p. 15

¹³³ Ministry of Health, Sri Lanka (2012). Annual Health Bulletin, p. 63

¹³⁴ *Ibid*, p. 82

¹³⁵ Ministry of Health, Sri Lanka (2012). Annual Health Bulletin, p. 100

¹³⁶ *Ibid*, p. 104

¹³⁷ Lanka on Globe, retrieved on 20th April 2016 from

<https://lankaonglobe.wordpress.com/2013/06/22/twenty-a-day-die-with-heart-diseases-in-sri-lanka/>

Sri Lanka's road network is dense and well laid-out providing connectivity to the country's population and centres of economic activity. The network's density is among the highest in Asia, as the number of road kilometres per population exceeds the related indicators of both Pakistan and of densely populated Bangladesh.¹³⁸ The national road network has evolved over more than one century. The beginnings of relatively modern paved roads date back to the late 19th century, when a system of trunk roads already provided basic spatial coverage for all major communities. At independence in 1948, Sri Lanka had about 11,000 km of trunk roads, of which 7,000 km were paved. This was by and large the configuration and the size of the current network of main arteries known as the national highway network (NHN). On all major routes, road transport competed with a railway system, which at independence comprised 1,460 km and has remained at this level ever since. In contrast, the road network has increased to about 116,000 km, of which about 30,000 km are paved.¹³⁹ According to the Road Development Authority of Sri Lanka there are 4,215 km A class roads, 7,995 km B class roads and 170 km expressway roads.¹⁴⁰

Currently, huge efforts are committed to develop the road network in Sri Lanka. Southern Expressway (126 km), Outer Circular Highway (18.9 km) and Colombo-Katunayake Expressway (25.8 km)¹⁴¹ projects have been completed and are currently in use. Colombo-Kandy Expressway (98 km), Colombo-Jaffna Expressway (213 km) and Extension Southern Expressway are in process.

¹³⁸ Ministry of Highways and Road Development, Sri Lanka (2007). National Road Master Plan (2007-2017), p.1

¹³⁹ *Ibid*, p. 2

¹⁴⁰ Road Development Authority, retrieved on 20th April 2016 from

http://www.rda.gov.lk/source/road_statistics.htm

¹⁴¹ *Ibid*, retrieved on 20th April 2016

With the development of roads and highways, the road accidents and their consequences vary in type and percentage.

Table 2.1: Road Accidents – The way they are taking place in Sri Lanka

Overview	Total	%
Deaths	2,436	6.75
Fatal Accidents	2,261	6.27
Minor Accidents	13,051	19.00
Critical Accidents	6,688	35.92
Damages Only	14,045	38.81

Source: Ministry of Transport & Civil Aviation – Sri Lanka¹⁴²

Table 2.2: Types of Vehicles Involved in Accidents in Sri Lanka

Vehicle Accidents	Fatal Vehicle Accidents			Total Vehicle Accidents		
	2012	2013	2014	2012	2013	2014
Year						
Motorcycles	715	723	845	9,877	9,430	8,962
Lorry	320	400	329	4,797	4,500	4,324
Dual Purpose Vehicles	305	265	259	7,184	6,413	5,198
Private Bus	257	217	180	3,357	3,001	2,936
Three-Wheelers	252	228	274	7,437	6,286	6,401
Total	1849	1833	1887	32,652	29,626	27,821

Source: Ministry of Transport & Civil Aviation – Sri Lanka¹⁴³

In this situation, there is a vital need for motor insurance / Takāful. The Takāful industry has to consider these factors and plan for future development projects and bring some new and sophisticated products to cater the situation and mentality of people.

¹⁴² Ministry of Transport & Civil Aviation – Sri Lanka, retrieved on 20th April 2016 from http://www.transport.gov.lk/web/index.php?option=com_content&view=article&id=279&Itemid=171&lang=en

¹⁴³ *Ibid*, retrieved on 20th April 2016

Sri Lanka is a country surrounded by natural disasters and hazards. Lareef, Vidhura, Upamala, Zeenas and Ruvini¹⁴⁴ revealed that the most frequent natural hazards that affect Sri Lanka are droughts, floods, landslides, cyclones, vector borne epidemics (malaria and dengue), and coastal erosion. Tsunamis are infrequent but have caused severe damage.¹⁴⁵ Recent understanding of the tectonics of the Indian Ocean region points to an increasing risk of earthquakes. The risk of volcanoes is small.

Figure 2.2 shows combined economic losses from the natural disaster 1990-2014.

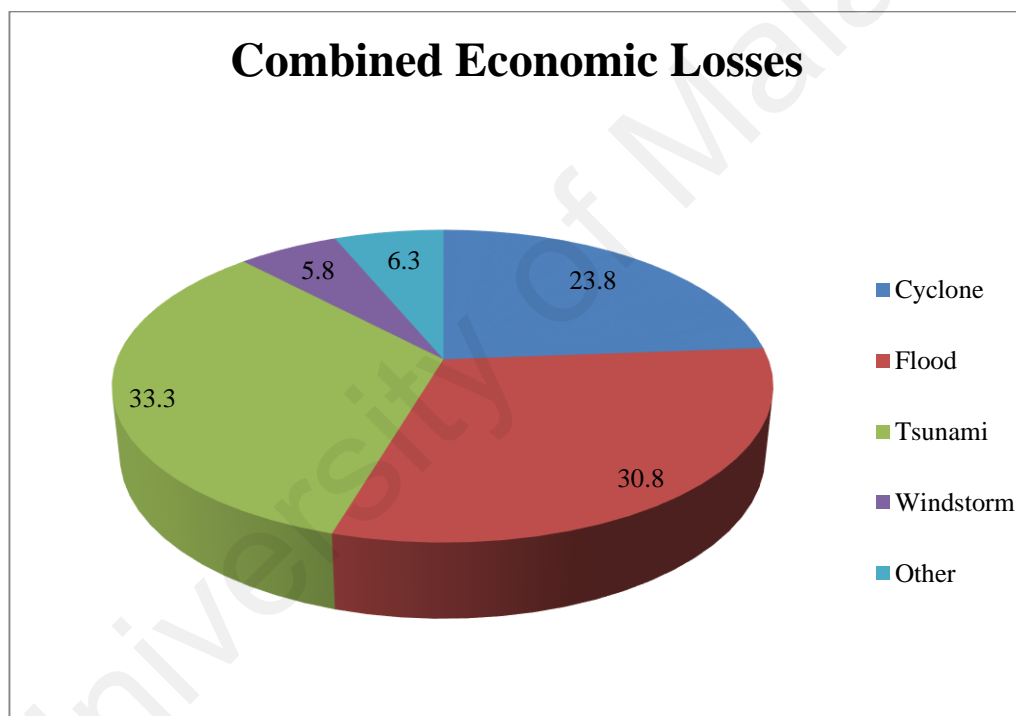


Figure 2.2: Combined Economic Losses by Disasters 1990-2014

Source: Preventionweb.net¹⁴⁶

¹⁴⁴ Lareef, Z., Vidhura, R., Upamala, T., Zeenas, Y. and Ruvini, P., Natural Disaster Risks in Sri Lanka: Mapping Hazards and Risk Hotspots, retrieved on 20th April 2016 from <http://water.columbia.edu/files/2011/11/Zubair2006NaturalDisaster.pdf> p. 109

¹⁴⁵ In 2004, almost two-thirds of the Sri Lankan coast affected by the Indian Ocean tsunami highlighting the country's vulnerability to low-frequency but high impact events.

¹⁴⁶ Preventionweb.net, retrieved on 20th April 2016 from <http://www.preventionweb.net/countries/lka/data/>

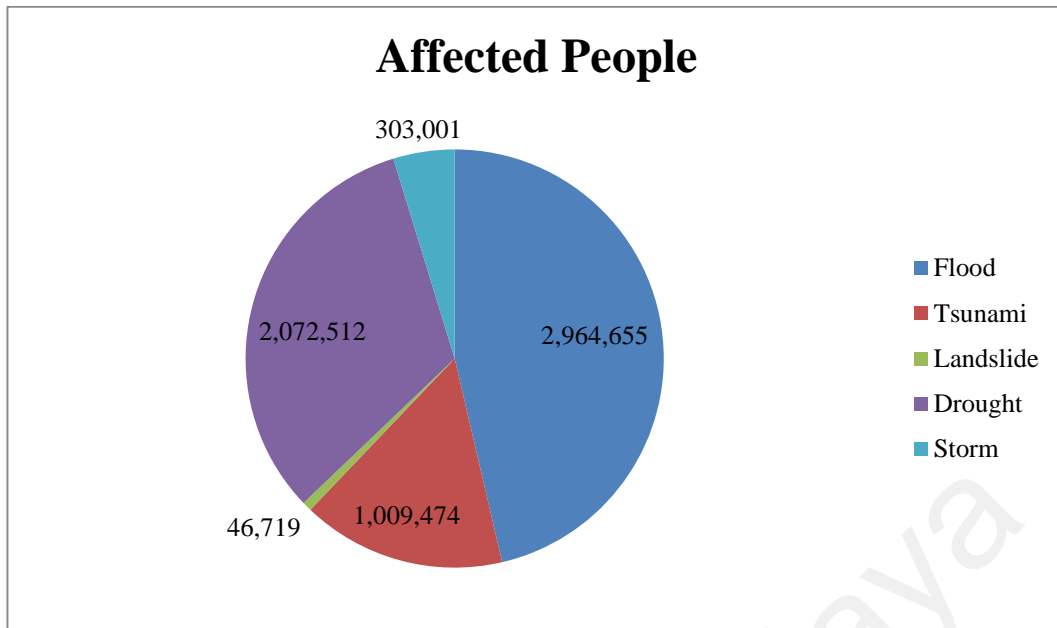


Figure 2.3: People Affected by Different Disasters in Sri Lanka (1974-2004)

Source: Ministry of Disaster Management¹⁴⁷

Figure 2.3 indicates the disasters and their effect on people's lives. Figures 2.2 and 2.3 reveal the high potentiality of insurance / Takāful in Sri Lanka. It is noteworthy that the Government of Sri Lanka is also positive and supportive to develop the insurance industry in Sri Lanka by imposing some rules and regulations connected to insurance policies in addition to regulatory and legal supports.

2.4 Regulatory Authorities for Insurance in Sri Lanka

Without interfering with the freedom of the individual, one of the state's obligations to its citizens is to protect the economy and maintain a balance between the state economy and the private market economy, such that private individuals and companies enjoy the greatest possible freedom in their activities.

¹⁴⁷Ministry of Disaster Mangement, retrieved on 20th April 2016 from http://www.disastermin.gov.lk/web/index.php?option=com_content&view=article&id=57%3Ahazard-profile-of-sri-lanka&catid=73%3AReports&Itemid=70&lang=en

The general purpose of insurance regulation is to protect the public against insolvency of insurance operators and minimise unfair treatment by insurers. From the state's viewpoint, regulation is also important as a revenue producer through state taxes on insurance premiums.¹⁴⁸

The insurance business is among the types of private enterprises subject to much government regulation. It is generally classed as a business which is "affected with a public interest". This characteristic is the reason why many forms of government supervision of insurance are deemed necessary. Although competition is an effective regulator for some businesses, in the field of insurance uncontrolled competition would work a hardship upon the buyers of insurance, most of who do not understand insurance contracts. Much of the insurance written is to protect third parties who have not participated in making the contracts. The value of the contracts depends upon the ability of the insurers to fulfil their promises to the public, sometimes many years after the insurance of a policy. Ability to carry out the provisions of contracts depends upon many factors, including the efficient operation of the insurer, the selection of satisfactory risks, the determination of proper premium rates, and the wise investment of adequate reserves. Consequently, the needed integrity and long range financial stability of insurers place insurance in an area which has traditionally been considered appropriate for government regulation.¹⁴⁹

According to Khorshid,¹⁵⁰ one of main purpose of state control has been to ensure that the insurer will be able to fulfil his obligations when the sum insured is due. Another concern is the possibility that insurers could dodge their legal obligations by drafting

¹⁴⁸ David, L. Bickelhaupt (1983). *General Insurance*, p.857

¹⁴⁹ *Ibid*, pp.857 and 858

¹⁵⁰ Khorshid, A., (2004). *Islamic Insurance – A Modern Approach to Islamic Banking*, p.159

provisions in a way that small print (which is rarely read in full) or complicated wordings could be used to invalidate claims and avoid payments.

Three basic methods of providing insurance regulation are available to government: (1) legislation, (2) administrative action, and (3) court action.

Corresponding to the three main branches of the government, each of these methods is significant in the supervision of insurance. Legislation is the foundation of insurance regulations, for it creates the insurance law. The insurance laws of each state are often combined in what is known as an insurance code, and these codes are of primary importance. Administrative action is also very important, as the application and enforcement of insurance laws are left in the hands of the insurance superintendent or commissioner in each state. Court action has great value in regulation because of its effect in providing detailed interpretations of troublesome parts of the law.¹⁵¹

Enacting a modern legal framework and designating a special judicial authority to handle insurance related cases are key requirements to enable market development by protecting the rights of policyholders and regulating the activities of market participants. A modern legal framework should regulate all insurance market participants, including insurance companies, intermediaries, and professionals. The regulations covering insurance companies should address a number of areas, including, among others, licensing, product approval, financial reporting, investments, reinsurance, and solvency margins. In addition, and in line with International Association of Insurance Supervisors (IAIS) principles, the regulations should stipulate the minimum internal capabilities of market players, such as governance and risk management. The regulations covering

¹⁵¹ David, L. Bickelhaupt, (1983). *General Insurance*, pp. 860 and 861

intermediaries and insurance professionals should entail, at a minimum, qualifications criteria, licensing requirements, and a code of conduct.¹⁵²

2.4.1 Central Bank of Sri Lanka (CBSL)

The Central Bank of Sri Lanka is the main responsible monetary body for entire monetary transactions of Sri Lanka.

2.4.1.1 Overview

Established in 1950 under the Monetary Law Act No.58 of 1949 (MLA), the CBSL is the apex institution in the financial sector in Sri Lanka. It is a semi-autonomous body and, following the amendments to the MLA in December 2002, is governed by a five-member Monetary Board, comprising the Governor of the CBSL as Chairman, the Secretary to the Ministry of Finance and Planning and three members appointed by the President of Sri Lanka, on the recommendation of the Minister of Finance, with the concurrence of the Constitutional Council.¹⁵³

With a view to encouraging and promoting the development of the productive resources of Sri Lanka, the CBSL is responsible for securing its core objectives of monetary policy, economic and price stability and sustain a stable financial policy. The CBSL is also responsible for currency issue and management. In addition, the CBSL is the advisor on economic affairs as well as the banker to the Government of Sri Lanka.

¹⁵² Peter Vayanos (booz&co.) Promoting the growth and competitiveness of the insurance sector in the Arab world, p.11, accessed on 20 December 2012 through http://www.booz.com/media/uploads/Insurance_Sector_Arab_world.pdf

¹⁵³ Official Website of Central Bank of Sri Lanka, retrieved from http://www.cbsl.gov.lk/htm/english/03_about/a_1.html on 3 June 2013

On behalf of Government of Sri Lanka, the CBSL, as its agent, is responsible for four agency functions of: management of the Employees Provident Fund; management of the public debt of Sri Lanka; administration of the provisions of the Exchange Control Act; and administration of foreign and government funded credit schemes for regional development.¹⁵⁴

2.4.1.2 Brief History

The Central Bank of Ceylon was set up by the post-independent government in recognition of the importance of an active monetary policy regime and a dynamic financial sector to support and promote economic growth.

Prior to the establishment of the Central Bank, functions relating to central banking were conducted by the Currency Board System that was set up under the Paper Currency Ordinance No. 32 of 1884.¹⁵⁵

After gaining political independence, the Currency Board System was considered inadequate and unsuitable for meeting the needs of a developing country and an independent nation. Therefore, in July 1948, the Government of Ceylon requested the United States Government for technical expertise to set up a central bank, which resulted in Mr. John Exter, an economist from the Federal Reserve Board of the USA being appointed to carry out this task.¹⁵⁶

¹⁵⁴Official Website of Central Bank of Sri Lanka, retrieved from http://www.cbsl.gov.lk/htm/english/03_about/a_1.html on 3 June 2013

¹⁵⁵*Ibid*, accessed on 3 June 2013

¹⁵⁶*Ibid*, accessed on 3 June 2013

The Exter Report on the rationale and the legal framework for the Central Bank was presented to the Government of Ceylon in November 1949 and led to its formation. The Central Bank of Ceylon was established by the Monetary Law Act (MLA) No.58 of 1949 and commenced operations on August 28, 1950. It was renamed the Central Bank of Sri Lanka in 1985.¹⁵⁷

2.4.1.3 Objectives of the Central Bank

The Central Bank's focus and functions have evolved since its formation, in response to the changing economic environment. In keeping with trends in central banking, the objectives of the Central Bank were streamlined by amending the Monetary Law Act (MLA) in 2002, to enable it to pursue its core objectives and to free it of the multiple objectives that were originally assigned to it. The Central Bank has two core objectives:

- Maintaining economic and price stability
- Maintaining financial system stability

With a view to encouraging and promoting the development of the productive resources of Sri Lanka.¹⁵⁸

2.4.2 Insurance Board of Sri Lanka (IBSL)

The insurance industry is regulated and supervised in terms of the provisions of the Regulation of Insurance Industry Act No. 43 of 2000 of Sri Lanka (hereinafter referred to as the RII Act). The Insurance Board of Sri Lanka was established under the RII Act.

¹⁵⁷Official Website of Central Bank of Sri Lanka, retrieved from http://www.cbsl.gov.lk/htm/english/03_about/a_1.html on 3 June 2013

¹⁵⁸*Ibid*, accessed on 3 June 2013

Prior to the promulgation of the Act the insurance industry was regulated by the Controller of Insurance acting under the powers vested by the Control of Insurance Act, No. 25 of 1962. Subsequently, this Act was repealed with the introduction of the Act¹⁵⁹ (No. 43 of 2000)

The IBSL has been established under the Act for the purpose of development, supervision and regulation of the insurance industry and to ensure that insurance business in Sri Lanka is carried out with integrity and in a professional and prudent manner, with a view to safeguarding the interests of policyholders and potential policyholders.¹⁶⁰

The vision of IBSL is to be the benchmark insurance regulator in South Asia. Its mission is to protect policyholders through prudential regulation, supervision and facilitation of the development of the insurance industry.¹⁶¹ According to the Act, its object and responsibility shall be, to ensure that insurance business in Sri Lanka is carried on with integrity and in a professional and prudent manner with a view to safeguarding the interests of the policy holders and potential policy holders.¹⁶²

Some of the functions of the IBSL are to register as insurers the persons carrying on insurance business, to register persons as insurance brokers, to advise the Government on the development and regulation of the insurance industry and to implement the policies and programmes of the Government with respect to the insurance industry.¹⁶³

¹⁵⁹ Annual Report, 2011. Insurance Board of Sri Lanka, p.16

¹⁶⁰ Annual Report, 2012. Insurance Board of Sri Lanka, p. 22

¹⁶¹ *Ibid.*, p. 4

¹⁶² Regulation of Insurance Industry Act No. 43 of 2000, p. 1

¹⁶³ Wimal, W. (2008). 'Situation Essays' on insurance in Sri Lanka, p. 29

The IBSL is in the process of revamping the current regulatory framework. In this regard, the regulator has already issued a directive requiring composite insurers to split their life and general businesses into separate legal entities; companies have been given 4 years to comply with this requirement. RAM Ratings Lanka notes that the larger and more well-established players are composite insurers; the separation of their businesses is seen as a challenge, exposing each player to operational risk during the transition period. At the same time, we derive some comfort from the relatively long period given by the IBSL to adhere to the regulations. In addition to segregation, the incumbents are expected to list each business line on the local stock exchange in the next 5 years.¹⁶⁴

Meanwhile, foreign-currency investments (limited to 20% of insurers' technical reserves or long term funds) have also been allowed, giving local companies the opportunity to tap diverse investment opportunities abroad. On top of that, the regulator has issued fresh solvency regulations in 2011, thus widening the range of investments acceptable as admissible assets and refining the definition of investments. These initiatives are viewed positively as they broaden investment avenues for insurers.¹⁶⁵

The National Insurance Trust Fund (NITF) will also come under the purview of the IBSL. The NITF is at present the only reinsurer in the country and comes under the purview of the ministry of finance local insurance players must cede 20% of their reinsurance premiums to the NITF. However, we note that the NITF is at liberty to decline reinsurance premiums if the reinsured amount exceeds its capacity. In addition, it operates the health insurance scheme for civil servants (known as *Agrahara*) and runs a general insurance business. Government departments are required to obtain insurance coverage,

¹⁶⁴ RAM, 2011. Insurance Sector Update – Bright Prospects Despite Regulatory Changes, p. 3

¹⁶⁵ *Ibid*, p. 3

only from either the NITF or Sri Lanka Insurance Cooperation, the other state-owned insurer.¹⁶⁶

The IBSL has many organisational links, for example, IAIS, established in 1994), the Institute of Chartered Accountants of Sri Lanka, Insurance Ombudsman's Office, Securities and Exchange Commission of Sri Lanka, Central Bank of Sri Lanka, Sri Lanka Government Web Portal, and Financial Services Academy.¹⁶⁷ As a member of IAIS, the IBSL has benefitted from its framework for regulation and supervision of the insurance industry, particularly from the IAIS Insurance Code Principles (ICPs), and in August 2005, it formulated an action matrix for compliance.¹⁶⁸

2.4.2.1 Market Structure

The insurance market of Sri Lanka has been structured by three kinds of insurance operators. They are insurance companies, insurance brokers, and insurance agents.

2.4.2.1.(a) Insurance Companies

In terms of Section 13 of the Act, a company interested in engaging in insurance business in Sri Lanka should incorporate a public company under the Companies Act, No. 7 of 2007 and register as an insurer under the Act after having fulfilled all statutory requirements under the Act.

¹⁶⁶ RAM, 2011. Insurance Sector Update – Bright Prospects Despite Regulatory Changes p. 3

¹⁶⁷ Wimal, W. (2008). 'Situation Essays' on insurance in Sri Lanka, p. 29

¹⁶⁸ *Ibid*, p. 30

According to annual report – 2012 of IBSL¹⁶⁹ and official website of IBSL,¹⁷⁰ there are 22 insurance companies were registered under the Regulation of Insurance Industry Act No: 43 of 2000. Table 2.3 reveals the names of the insurance companies, their classes of insurance and their date of registration.

Table 2.3: Registered Insurance Companies in Sri Lanka

Name of Insurer	Class of Insurance	Date of Registration
AIA Insurance Lanka PLC (formerly AVIVA NDB Insurance PLC)	Long Term Insurance	16 th December 1987
	General Insurance	29 th December 1987
AIG Insurance Limited	General Insurance	13 th December 1999
Allianz Insurance Lanka Ltd.	General Insurance	29 th September 2004
Allianz Life Insurance Lanka Ltd.	Long Term Insurance	01 st July 2008
Amana Takaful PLC	Long Term Insurance	01 st February 2002
	General Insurance	
Arpico Insurance Limited	Long Term Insurance	20 th October 2011
Asian Alliance Insurance PLC	Long Term Insurance	08 th March 2000
	General Insurance	17 th September 1999
Ceylinco Insurance PLC	Long Term Insurance	11 th February 1987
	General Insurance	
Ceylinco Takaful Ltd.*	General Insurance	16 th May 2006
HNB Assurance PLC	Long Term Insurance	30 th August 2001
	General Insurance	
Janashakthi Insurance PLC	Long Term Insurance	12 th August 1994
	General Insurance	11 th September 1995
Life Insurance Corporation (Lanka) Ltd.	Long Term Insurance	18 th December 2002
LOLC Insurance Company Limited	Long Term Insurance	30 th April 2010
	General Insurance	
MBSL Insurance Company Ltd.	Long Term Insurance	01 st April 2005
	General Insurance	02 nd August 2005
National Insurance Trust Fund Board	General Insurance	
Orient Insurance Limited	General Insurance	15 th October 2011
People's Insurance Limited	General Insurance	02 nd December 2009
Seemasahitha Sanasa Rakshana Samagama	Long Term Insurance	08 th July 2003
	General Insurance	06 th January 2005

¹⁶⁹ Insurance Board of Sri Lanka, Annual Report, 2012, p. 89 (Appendix I)

¹⁷⁰ Insurance Board of Sri Lanka, Official Website, retrieved from <http://www.ibsl.gov.lk/index.php/insurance-companies> on 1 April 2014

Table 2.1 Continued:

Name of Insurer	Class of Insurance	Date of Registration
Sri Lanka Insurance Corporation Ltd.	Long Term Insurance	03 rd February 1993
	General Insurance	
Union Assurance PLC	Long Term Insurance	08 th January 1987
	General Insurance	

*Ceylinco Takāful Limited is prohibited from engaging in insurance business since 05th August 2009.

Source: Annual Report, 2014 of IBSL

2.4.2.1.(b) Insurance Brokers

An insurance broker is a company incorporated under the Companies Act, No. 07 of 2007 and registered under the Act in order to carry out insurance brokering business. Insurance Brokers function as intermediaries for the placing of insurance business for or on behalf of an insurer, a policyholder or a proposer for insurance or reinsurance, with an insurer or reinsurance company, in expectation of a payment by way of brokerage or commission.¹⁷¹

At the end of 2014, there were 58 companies registered as insurance brokers. Out of the said companies, 39 companies were registered in both long term and general insurance brokering business while 19 companies were registered only in general insurance brokering business.¹⁷²

¹⁷¹ Annual Report, 2014. Insurance Board of Sri Lanka, p. 22

¹⁷² *Ibid*, p. 22

2.4.2.1.(c) Insurance Agents

An individual registered as an insurance agent with an insurer or an insurance broker under the Act and who in consideration of a commission solicits or procures insurance business for such insurer or insurance broker. Qualifications for registration have been specified by the Board.

The Regulation of Insurance Industry (Amendment) Act, No. 3 of 2011 permits persons other than individuals to function as insurance agents. As per Section 34 of the Act insurance agents are one of the important distribution channels in which insurers and insurance brokers procure insurance business.

As per information given by insurers, the total number of individuals recruited as insurance agents during the year was around 12,604. Total number of insurance agents representing insurers as at the end of year was around 36,801.¹⁷³

2.4.2.2 Company Status and Changes in Capital

Out of the insurers, seven companies are listed on the Colombo Stock Exchange namely, Ceylinco Insurance PLC, AIA Insurance Lanka PLC, Union Assurance PLC, Asian Alliance Insurance PLC, HNB Assurance PLC, Amana Takāful PLC and Janashakthi Insurance PLC.

The Amendment Act requires an existing insurer to be listed on a stock exchange licensed under the Securities and Exchange Commission of Sri Lanka Act, No. 36 of 1987

¹⁷³ Annual Report, 2014. Insurance Board of Sri Lanka, p. 23

within a period of five years from the date of operation of the Amendment Act. Composite insurance companies would therefore, have to segregate its business into two separate companies within a period of four years from the date of operation of the Amendment Act prior to obtaining a listing.¹⁷⁴

The Board is closely working with the Insurance Association of Sri Lanka (IASL) to facilitate a smooth process for segregation.

A new company registered as an insurer after the Amendment Act came into effect is required to be listed on a stock exchange licensed under the Securities and Exchange Commission of Sri Lanka Act, No. 36 of 1987 within a period of three years of being issued a license by the Board.

The paid-up share capital of a company registered as an insurer prior to June 2011 has been required to be increased by the Board to a minimum of rupees five hundred million, for each class of insurance business on or before 11 February 2015.¹⁷⁵

In the case of insurance brokers, the Board has required a company registered as an insurance broker to have a paid-up share capital of not less than rupees two million five hundred thousand on or before 31st December 2014.

The Board is also in the process of introducing the Risk Based Capital Rules for insurers. Foreign equity participation in insurance companies has been permitted up to

¹⁷⁴Annual Report, 2012. Insurance Board of Sri Lanka, p. 23

¹⁷⁵*Ibid*, p. 23

100% in terms of the Gazette Notification No. 1232/14 published by the Controller of Exchange in April 2002.¹⁷⁶

2.4.2.3 Other Related Matters

There are other things relevant to insurance industry of Sri Lanka.

2.4.2.3.(a) National Council for Road Safety (NC RS)

The National Council for Road Safety established under the Motor Traffic Act is under the purview of the Ministry of Transport. Every insurer providing motor insurance cover is required to contribute 1% of third party insurance premiums to the Road Safety Fund. The Board is represented on the NCRS.¹⁷⁷

2.4.2.3.(b) Inter Regulatory Institutions Council (IRIC)

The Inter Regulatory Institutions Council was established by the CBSL. This high level committee chaired by the Governor of the CBSL was set up to ensure that appropriate policy directions are set out for orderly development of financial markets and that all regulatory agencies co-ordinate and exchange information in the interests of the entire financial system. The Board is represented on the IRIC.¹⁷⁸

¹⁷⁶Annual Report, 2012. Insurance Board of Sri Lanka, p. 24

¹⁷⁷ *Ibid*, p. 25

¹⁷⁸ *Ibid*, p. 25

2.4.2.3.(c) Insurance Association of Sri Lanka (IASL)

The Insurance Association of Sri Lanka (IASL) was established in 1989 and every insurance company registered under the Act is eligible for membership. All insurance companies other than NITF are members of IASL.

The Executive Committee of IASL is responsible for the overall management, assisted by the Life Insurance Forum, the General Insurance Forum and the Finance and Actuarial Sub-Committees, which make recommendations to the Executive Committee on subjects relating to their respective areas.¹⁷⁹

2.4.2.3.(d) Sri Lanka Insurance Brokers' Association (SLIBA)

The Sri Lanka Insurance Brokers' Association (SLIBA) is the only association of insurance brokers that has been approved by the Board. In Section 79 of the Act, it is mandatory that all applicants seeking registration as insurance brokers obtain membership of SLIBA prior to registration as an insurance broker by the Board. The members are subject to a code of conduct adopted by SLIBA.¹⁸⁰

2.4.2.3.(e) Sri Lanka Insurance Institute (SLII)

The Sri Lanka Insurance Institute (SLII) which was established in 1982 is a non-profit making organisation whose main objective is to develop the skills and knowledge

¹⁷⁹Annual Report, 2012. Insurance Board of Sri Lanka, p. 20

¹⁸⁰ *Ibid*, p. 25

of persons who are in the insurance business. Funding for SLII is through contributions made by insurance companies and annual subscriptions from its members.¹⁸¹

2.4.2.3.(f) International Association of Insurance Supervisors (IAIS)

As a member of the International Association of Insurance Supervisors (IAIS), the Board regularly receives publications, guidelines such as insurance core principles, and information on the activities of IAIS. Some of the core principles recommended by the IAIS are adopted by the Board for effective supervision and monitoring of the insurance industry in Sri Lanka.¹⁸²

2.5 Conclusion

Chapter two provided a clear picture about Sri Lanka and its insurance regulatory framework for Takāful which falls under the same Act that governs all other conventional insurance companies.

¹⁸¹*Ibid*, p. 26

¹⁸²Annual Report, 2012. Insurance Board of Sri Lanka, p. 26

CHAPTER 3: TAKĀFUL - DEVELOPMENTS AND CHALLENGES

3.1 Introduction

This chapter examines the concepts of Takāful and its practices. It will be divided into three parts excluding introduction and conclusion. The first part (3.2) will look into Islamic insurance (Takāful) and its related theoretical themes. It will deal with a brief introduction to Takāful, its definition, its history, its importance and significance, its characteristics and finally Takāful and conventional insurance.

The second part (3.3) will investigate the developments of Takāful. In doing this, spread and growth, policies/products, models, contracts, Takāful windows, retakāful, bancatakāful, regulation and governance and investments of Takāful will be detailed.

The third part (3.4) of this chapter will focus on the challenges of Takāful. In this part, lack of public awareness, shortage of expertise and skilled staff, regulatory challenges, marketing challenges and other challenges will be discussed.

3.2 Islamic Insurance (Takāful)

Islam is a global phenomenon and its influence on society and economy is ubiquitous. In Africa, Islam is the most dominant religion and over 52% of the population are Muslims. In Asia, where over 32% of population abide by Islamic principles. Muslims also comprise approximately 8% of the European population. 1.97 billion Muslims live in 184 different countries, comprising about 29% of world population in 2011.¹⁸³ In the

¹⁸³ www.muslimpopulation.com/world/ accessed 31 May 2012

US, the number of Muslims has grown from mere 10,000 in 1900 to over 1 million in 2000 and 6 million in 2010.¹⁸⁴

As the true religion of Allah, the most merciful, Islam has to provide guidance in every sphere of life. This guidance is not limited to the spiritual and social aspects but also covers economic dimension of human life. Islamic economic system supports interest free financial system. And also commands the human beings to commercial transaction with justice and honesty. It directs the people right path in financial matters.

All human beings are invariably exposed to the likelihood 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 belief of all Muslims in Allah and *al Qadā' wa al Qadr* (القضاء والقدر), Islam provides that one must find ways and means to avoid such catastrophe and disaster wherever possible, and to lighten its impact on his or his family security should such an event occur. One possible resort in this contest is insurance cover as available in the conventional system. Eminent Islamic jurists, scholars and researchers have developed the Takāful system of Islamic insurance based on *Al-Qur'an*, *Al-Sunnah* and related sources of Islamic jurisprudence as an alternative for prevailing conventional insurance system.

Insurance is a socioeconomic institution which reduces risk to both individuals and society. It has many social and economic values, and the greatest one comes on the format of the benefits following from the reduction of risk in society. Insurance therefore

¹⁸⁴ New York Daily News, 3rd May 2012, "Number of Muslims doubles in the U.S. since 9/11" available at www.vdare.com accessed 31 May 2012

has the advantage of being a device to handle risk and, hence it is necessary that its services be extended in order to bring about the greatest economic advantage to society.

There is no doubt that the religion of Islam is designed to cater for human wellbeing through its teachings, laws and legislations and also to aims to establish a peaceful society, harmonious brotherhood all operating under the economic justice, eradicating poverty, promoting stability, maintaining law and order and to ensure social and economic justice..¹⁸⁵

Efforts to avoid risk are not against the *Sharī'ah* tenets. Belief in God or destiny does not mean that man should be exposed to unnecessary risks, and *Sharī'ah* accepts the basic safety requirement of human beings and their belongings. This includes protection of self, protection of one's offspring and wealth, protection against disease, illiteracy and poverty and other misfortune..¹⁸⁶

3.2.1 Definition

The approximate *Sharī'ah* equivalent of the word for insurance in Arabic is “*Ta'mīn*”¹⁸⁷ (التأمين), which means to reassure, safeguard and guarantee through indemnity to losses. It also denotes fidelity, loyalty, confidence and trust and refers more to guarantee than to cooperative sharing of losses among a group. This concept remained under discussion among Muslim scholars for about a century..¹⁸⁸

¹⁸⁵ Umar Chopra, M., *The Islamic Welfare State and its Role in the Economy*, pp.11-20

¹⁸⁶ Ayub, M. (2007). *Understanding Islamic Finance*, P.418

¹⁸⁷ “Insurance is a contract (generally a standard form contract) between the insurer and the insured, known as the policyholder, which determines the claims which the insurer is legally required to pay. In exchange for an initial payment, known as the premium, the insurer promises to pay for loss caused by perils covered under the policy language.” Definition given by Īsā ‘Abduh, (1978). *Al Ta'mīn baina al Ḥill wa al Tahrim*, *Maktabah al Iqtiṣād al Islāmi*, p. 26

¹⁸⁸ Ayub, M. (2007). *Understanding Islamic Finance*, p. 420

Before defining the term, it is worth mentioning that Islamic insurance is also known by several other names, which include cooperative insurance, Takāful, and *Ḥalāl* insurance. The use of these different terms can easily be inferred from the names of the companies which are known to offer *Sharī'ah* compliant insurance products throughout the globe.

The first term, i.e. cooperative insurance, is mainly used by the companies in the Middle Eastern region, particularly Saudi Arabia and Sudan. For example, in Saudi Arabia, more than half of the companies incorporated therein are named after the term 'cooperative insurance'. This is not surprising, because the law of the country requires all insurance companies (registered in Saudi Arabia) to operate in accordance with the cooperative insurance method.

The term '*Ḥalāl* insurance' was popularised by the first ever independent Islamic insurance provider in the United Kingdom called *Salaam Ḥalāl* Insurance. The term, however, appears to have faded recently, as the company ceased to accept new business due to unfavourable market conditions.

Takāful is perhaps the most popular term used by Islamic Insurance operators in current times, it is extensively used by the industry players as well as by academia. In Malaysia, a special Act called the Takāful Act was introduced in 1984 to administer the operation of Islamic insurance companies in the country. Consequently, Takāful is statutorily synonymous with the notion of Islamic insurance in Malaysia. Many international events and published reports are also seen as proposing Takāful as a proper term for the Islamic insurance industry. Some of the prestigious events regarding Islamic insurance are labelled Takāful such the international Takāful summit (held

annually in London) and world Takāful conference (held annually in Dubai). There are also many reports published by auditing firms and rating companies such as standard & Poor's, Ernst & Young and AON that directly address Islamic insurance as Takāful. There are significant reports that highlight the overall performance of the Islamic insurance industry worldwide is The World Takāful Report which is published by Ernst & Young on an annual basis.

It should be noted, however, that there is no unanimity in the use of the term Takāful to connote the whole idea of Islamic insurance. For example, in most Arab countries, particularly Saudi Arabia and Sudan, Takāful appears to specifically refer to Islamic version of life insurance schemes. The Islamic version of general insurance, in the other hand, is purposely distinguished by the using of the term Islamic insurance or cooperative insurance. In Swiss Re's serial publication *Sigma*, it is also stated that Islamic insurance is distinguished from Takāful while the former refers specifically to insurance models that use segregated funds for policyholders and shareholders.¹⁸⁹

It is pertinent to point out that the word Takāful in Arabic is not used only for Islamic insurance. But this term is used for other ideologies and contexts by Muslim scholars such as for instance in *Al Takāful Al Ijtimā'ī fi Al-Islam*, a book written by Muhammad Abu Zahrah,¹⁹⁰ this term is used to explain the holistic social solidarity of Islam.

¹⁸⁹ Kamaruzaman bin Noordin in his unpublished PhD thesis titled 'The commercialisation of Islamic insurance (Takāful): a critical study of Takaful business models in Malaysia', pp. 54 and 55

¹⁹⁰ Abu Zahrah, M. (n.d.). *Al Takāful Al Ijtimā'ī fi Al-Islam*

Takāful (تكافل) is an Arabic word derived from the root-word “Kafala” (كفل), a verb that means guarantee, bail, warrant or an act of securing one’s need.¹⁹¹ It has meanings of responsibility and assurance too. When ‘ta’ (ت) is prefixed to the word, it conveys the idea of two or more parties who provide mutual guarantee to one another. In this connection, the meaning of Takāful as an Arabic word to express joint guarantee, assuring each other, joint benefit, shared responsibilities, guaranteeing and caring for one another, becomes relevant.

In Islamic insurance, Takāful refers to an arrangement for mutual indemnity in providing protection and compensation to participants who suffer financial loss from perils and hazards.

According to part I of the Islamic Financial Services Act 2013 of Malaysia:

Takāful means an arrangement based on mutual assistance under which Takāful participants agree to contribute to a common fund providing for mutual financial benefits payable to the Takāful participants or their beneficiaries on the occurrence of pre-agreed events.¹⁹²

Bank Negara Malaysia introduces a similar definition in its website.

Takāful (Islamic insurance) is a concept whereby a group of participants mutually guarantee each other against loss or damage. Each participant fulfils his / her obligation by contributing a certain amount of donation (or tabarru’) into a fund, which is managed by a third party - the Takāful operator.¹⁹³

The Accounting, Auditing and Governance Standards for Islamic Financial Institutions (2004/05) provides:

Islamic insurance is a system through which the participants donate part or all of their contributions which are used to pay claims for damages suffered by some

¹⁹¹ Ali, E.R.A.E. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 3

¹⁹² Islamic Financial Services Act, 2013, Bank Negara Malaysia, p. 24

¹⁹³ Bank Negara Malaysia, Official Website

http://www.bnm.gov.my/index.php?ch=fs_mfs&pg=fs_mfs_bank&lang=en#Takaful retrieved on 27 July 2012

of the participants. The company's role is restricted to managing the insurance operations and investing the insurance contributions (Financial Accounting Standards No. 12, in Appendix E).¹⁹⁴

The AAOIFI's *Sharī'ah* Standard 26 of 2008 provides:

Islamic insurance is a process of agreement among a group of persons to handle the injuries resulting from specific risks to which all of them are vulnerable. A process, thus initiated, involves payment of contributions as donations, and leads to the establishment of an insurance fund that enjoys the status of a legal entity and has independent financial liability. The resources of this fund are used to indemnify any participant who encounters injury, subject to a specific set of rules and a given process of documentation. The fund is managed by either a selected group of policyholders, or a joint stock company that manages the insurance operations and invests the assets of the fund, against a specific fee.¹⁹⁵

The Islamic Financial Service Board (IFSB) and International Association of Insurance Supervisors give the following description:

Takāful is the Islamic counterpart of conventional insurance, and exists in both life (and 'family') and general forms. It is based on concepts of mutual solidarity, and a typical Takāful undertaking will consist of a two-tier structure that is a hybrid of a mutual and a commercial form of company.¹⁹⁶

In short, Takāful is a system of cooperative risk sharing in such a way that on the one hand, the basic prohibitions of *Sharī'ah* are taken care of and the requirements of the socioeconomic and financial framework are fulfilled. The losses of the unfortunate few are shared by the contributions of the fortunate many that are exposed to the same risk on a cooperative risk sharing basis. The funds are used by the manager/trustee for payments of claims and prudently invest/manage idle funds in a *Sharī'ah* compliant manner. The underwriting surplus or deficit belongs to the group members. The manager of the pool gets a return in the form of a fee and/or share from the profit made from the investments of the funds in *Sharī'ah* compliant avenues.¹⁹⁷

¹⁹⁴ Ali, E.R.A.E. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp. 3 and 4

¹⁹⁵ AAOIFI (2008), *Sharī'ah* Standards for Islamic Financial Institutions, p.471

¹⁹⁶ Ali, E.R.A.E. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp. 3 and 4

¹⁹⁷ Ayub, M. (2007). Understanding Islamic Finance, P.421

3.2.2 History

The origins of insurance can be traced to the gradual evolution of human societies and the individual and collective social needs that arose because of such progress. According to Farooq, Chaudhry, Fakhr-e-Alam and Ahmad,¹⁹⁸ insurance emerged the transformation of the agrarian society into a modern industrial society. The process of industrialisation has been so rapid that it may rightly be described as a revolution. This revolution did not eliminate the chance of loss of life and property. The development in transportation industry, the increased use of machinery, all these are followed by risks like accidents, hazards and injuries. It was to mitigate the seriousness of these unexpected risks that a system of risk management began to gradually take shape.

These developments that originated in the western world during the last four hundred years began to exert a strong influence on Muslim societies. But the operating models of those initiatives were not consonant with Islamic values and principles. Muslim scholars and economists became more and more conscious of this conflict and attempts to develop the alternate socioeconomic system, which could fulfil the needs of Muslims in the wider spheres of commerce, industry, agriculture, and individual business endeavours.

Muslims believe that resources of various kinds in this world are the gift of Allah, which have been given as a trust to mankind, to utilise them in the most efficient manner aiming to produce maximum benefit for mankind. As part of the continuing surge of commitment to revive the Islamic way of life, the reorganisation of finance and economy

¹⁹⁸ Farooq, S.U., Chaudhry, T.S., Fakhr-e-Alam and Ahmad, G. (2010), An Analytical Study of the Potential of Takāful Companies, p.55

in human societies became part of that commitment involving the tackling of the needs and problems of daily life of Muslims.

In contrast to the earlier opinion, Muhammad Ayub holds a slightly different opinion in this regard. He says,¹⁹⁹

The insurance business is conducted mostly by non-bank financial institutions (NBFIs) and the commercial banks are not allowed, in most countries, to be involved in the insurance business. However, all commercial and investment banks and other NBIFs have to resort to insurance services, either as a regulatory requirement or as an unavoidable business need. Similarly, business, industry and individuals have been increasingly taking on the services of insurance companies to safeguard against unfortunate incidents and losses to life and wealth. While Islamic banking emerged in the 1960s and early 1970s, Islamic insurance started not earlier than 1979. This reveals that the Takāful system developed in response to the demand for risk cover by Islamic financial institutions, due mainly to the fact that banking and insurance go hand-in-hand and complement each other's operations.

As Muslims we are required to examine all theories and practices covered in the field of economics from the perspective of Islamic laws and values as enshrined in the *Al-Qur'an* and the *Al-Hadīth* (report of the sayings or actions of Muhammad or his companions). The economic activities, which are permitted by *Sharī'ah*, do not support capitalism or socialism. These Islamic principles are based on the prohibition of interest (*ribā*) ربا, engaging in permissible (*ḥalāl*) حلال, avoiding the Prohibited (*ḥarām*) حرام, Prohibition of entering into contracts containing elements of uncertainty (*gharar*) غرر or speculation, or gambling (*maisir*) ميسر and Payment of *Zakāh* زكاة. Muslim must also rely on Allah's destiny (*Taqdīr*) تقدير or dependent (*Tawakkul*) توكل of Allah for his subsistence and security.

¹⁹⁹ Ayub, M., (2007). Understanding Islamic Finance, p. 418

There is also the requirement for harmony with the objectives (*maqāṣid*) of the *Shari'ah* with regard to securing benefits for Muslims or preventing harm befalling Muslims not only in this world but also in the hereafter. These objectives are religion (دين), life (حياة).

The history of Takāful can be classified into five periods, namely the pre-Islamic period, the period of Prophet Muḥammad (PBUH), the period of Umar bin Al Khattāb, the period of Umar bin Abdul Azīz, and the modern period.

3.2.2.1 Pre-Islamic Period

The custom of nomadic groups of Arabs (Bedouins) who lived between Egypt and Mesopotamia thousands of years before Christ of paying *diyāh*, (دية) blood money, is argued to be the true origin of mutual insurance in the history of human civilisation. This is supported by the fact that Egypt and Mesopotamia are considered by historians to be the oldest centres of human civilisation. *Diyāh* means a fixed monetary value paid by the tribe of the offender (or murderer) to the tribe of the victim (or his next of kin) as a compensation for the loss of life or injury. It could be 1000 dinars or 10,000 dirhams or 200 head of cattle or 100 head of sheep or 100 camels or 200 garments.

This system was devised by the Arabs to avoid bloodshed and devastation caused by revenge-seeking on part of the victim's tribe. In other words, it is a substitute for the law of private vengeance. It is obvious that the amount of compensation is too big to be borne by the offender himself. Therefore, a group of people with a common interest in the defendant (usually the male relatives of the murderer from the father's side), termed

'*āqilah* (عاقلة), will mutually contribute to the amount of *diyah* as a duty to prevent retaliation and destruction reaching the tribe.²⁰⁰

Billah explains that in the Arab customs '*Āqilah* refers to payee of blood wit. '*Aqlun* is the *Maṣdar* of '*Aqala* which means to tie or prevent. The word '*Aqlun* was used to mean blood wit because when a tribe of a killer bring camels as settlement of the blood wit they use to tie them in the corridor of the killed tribe. It also said that the word '*Aqlun* refers to blood wit because the tribe of the killer defend him by paying blood wit.²⁰¹

According to A.M. Sabbagh,²⁰² the *al-'āqilah* system's summary is: If one commits a non-premeditated murder, where it requires blood money and not vengeance, the blood money of the murdered soul is normally shared between the members of his tribe and it is paid in instalments during three years. The point is that the members of the tribe help each other and that Islamic law binds them to remedy the impact of the harm caused by the murder by mistake in equal instalments. The idea on which the regime of the reasonable is based is the distribution of the financial obligation in the catastrophe of murder by mistake through the obligatory donation. And it is the same idea as that of the mutual insurance that is based on the *Takāful* help to remedy the effects of the catastrophes and dangers by way of obligatory donations.

The principle of compensation in cash or kind (such as camels) had four outstanding benefits for the people of Arabia:

²⁰⁰ Kamaruzaman bin Noordin in his unpublished PhD thesis titled 'The commercialisation of Islamic insurance (Takāful): a critical study of Takāful business models in Malaysia', pp. 24 and 25

²⁰¹ *Al-Mawsū'ah al-Fiqhiyyah* Vol.29, P 221 as quoted in Billah, M.M., *Doctrines Justifying Islamic Insurance/Takāful*, p. 5

²⁰² Sabbagh, A.M. (2006). *Islamic Cooperative Insurance* (paper submitted at World Takāful Conference – Dubai, UAE, pp. 2,3

1. It reduced bloodshed and blood feuds in the country.
2. It replaced individual responsibility with the ultimate collective responsibility of the tribe for the actions of its members, and thus helped achieve social security for individual members of each tribe.
3. It reduced the financial burden of the individual by transferring it to the group.
4. It developed a spirit of cooperation and brotherhood among the members as reflected in mutuality to share the individual burden among the group.²⁰³

Ma'sum Billah²⁰⁴ revealed that the original concepts of Takāful are not newly invented in the modern period. Its principles originated from Prophetic period or some are even before. Some of the words used in Islamic History, prehistory of Islamic era and Islamic jurisprudence are well relevant to Takāful concepts. He explains that القسامة (*Al-Qasāmah*) Oath/swear (an oath that was taken from the kinsmen of the murdered; in one such case the holy Prophet paid blood money of one hundred camels of *Ṣadaqah*²⁰⁵) الفدية (*Al-fidyah*) Ransom, استجارة (*Istijārah*) Asylum, الحلف (*Al-hilf*) Guaranteeing a help through mutual agreement, الموالاة (*Al-muwālah*) Clientage with friendly cooperation or a contract in which one party agreed to bequeath his property to the other on the understanding that the benefactor would pay any blood money that may eventually be due to the former,²⁰⁶ العاقلة (*Al-'āqilah*) Slayer's paternal relative who undertakes to pay blood wit or kinsmen,²⁰⁷ الضمان (*Al-ḍamān*) Surety / Bailment / Assurance in civil liability, الكفالة (*Al-kafālah*) Bailment, ضمان على خطر الطريق (*Ḍamān 'ala khaṭar al-ṭarīq*) Surety for hazards on highway.

²⁰³ Afzalur Rahman (1979). Economic Doctrines of Islam, in: INCEIF (2012). Takāful – Realities and Challenges, pp. 55 and 56

²⁰⁴ Billah, M.M., Doctrines Justifying Islamic Insurance/Takāful, pp. 1-14

²⁰⁵ Sunan Ibn Majah, *Kitāb al Diyat*, vol. 3, p. 684, Hadith no: 2677

²⁰⁶ Ayub, M. (2007). Understanding Islamic Finance, P.420

²⁰⁷ *Ibid*, P.420

3.2.2.2 Period of Prophet Muḥammad (PBUH)

With the advent of Islam, the same practice was continued due to its benefits – as is evident from certain injunctions in *Al-Qur'an*.²⁰⁸ Qur'anic evidence clearly supports the practice of paying compensation in terms of blood money (*Al-diyah*), although the law of equality allows revenge only to the same extent. Islam also mitigated the horrors of the pre-Islamic custom of retaliation and revenge for injuries by prescribing the law of equality in all such cases.²⁰⁹ Forgiveness and mercy, instead of retaliation, were strongly recommended to avoid bloodshed in the community.²¹⁰

With the recommendation of *Al-Qur'an*, the *diyah* and '*āqilah* practice was approved by the Prophet Muhammad (PBUH)²¹¹ and further developed by his companions, particularly 'Umar bin Khattāb. As a result, the practice of *diyah* is also considered by many scholars as the foundation of Islamic insurance, apart from its link to mutual insurance.²¹²

The '*Āqilah*, a customary practice of the early Arab period has been approved by the Prophet (PBUH) and it can be observed from the following *Hadīth*:

Narrated by Abu Hurairah (R.A.), he said that: once two women from the tribe of *Huzail* clashed when one of them hit the other with a stone, which killed her and also the foetus in the womb. The heirs of the victim brought an action to the court of the Holy Prophet (pbuh), who gave a verdict that the compensation for the foetus is freeing of a male or female slave while the compensation for the

²⁰⁸ For instance: *Al-Qur'an*, *Sūrah Al-Baqarah*:178 and *Sūrah Al-Nisā*:91

²⁰⁹ *Ṣaḥīḥ Muslim*, *Kitāb Al-Birr*, *Hadīth* No: 984

²¹⁰ INCEIF (2012). *Takāful – Realities and Challenges*, p. 56

²¹¹ *Ṣaḥīḥ al-Bukhārī*, vol. 9, book 83, no. 41 and the Prophet said "*I Am the Legal Heir of a person who does not have any heir and I pay blood wit to discharge him from liability and I become his Heir*" Abū Dawūd Vol 3 P. 320: Cited in *Al-Mawsū'ah al-fiqhiyyah* Vol. 29 P. 226

²¹² Kamaruzaman bin Noordin in his unpublished PhD thesis titled 'The commercialisation of Islamic insurance (Takāful): a critical study of Takāful business models in Malaysia', pp.24 and 25

killing of the woman is the blood money (*diyyah*) which is to be paid by the ‘*āqilah* (the paternal relatives) of the deceased.²¹³

The basic concept of insurance in Islam has existed since the earliest period of Islamic emergence. The essence of insurance in the Islamic system could be seen in the establishment of the treasury (بيت المال) in order to help look after the welfare of the Muslims and these reside within the Islamic domain. Another institution of the greatest form of insurance which Islam has legislated for its followers is *Zakāh* (the obligatory charity). In this system the money will be collected from the wealthy by the appointed authority and be distributed to those who deserve to receive from this fund as outlined in *Al-Qur’an*.

إِنَّمَا الصَّدَقَاتُ لِلْفُقَرَاءِ وَالْمَسَاكِينِ وَالْعَامِلِينَ عَلَيْهَا وَالْمُؤَلَّفَةِ قُلُوبُهُمْ وَفِي الرِّقَابِ وَالْغَارِمِينَ وَفِي سَبِيلِ اللَّهِ وَابْنِ السَّبِيلِ فَرِيضَةً مِّنَ اللَّهِ وَاللَّهُ عَلِيمٌ حَكِيمٌ²¹⁴

“Alms are for the poor and the needy, and those employed to administer the (funds); for those whose hearts have been (recently) reconciled (to Truth); for those in bondage and in debt; in the cause of Allah; and for the wayfarer: (thus is it) ordained by Allah, and Allah is full of knowledge and wisdom.”²¹⁵

Among those deserving to receive this fund are those in debt (الغارمون). According to Yusuf al Qardāwi, some of the early interpreters of the word *ghārim* said, “it denotes one whose house has burned down or whose property or trade has been destroyed by flood or other disasters”.²¹⁶

²¹³ *Ṣaḥīḥ al-Bukhārī*, vol. 9, book 83, no. 41

²¹⁴ *Al-Qur’an*, *Sūrah al Tawbah* (9): 60

²¹⁵ Abdullah Yusuf Ali,

²¹⁶ Yusuf al Qardāwi, (1985). *Al Ḥalāl wa Al Ḥarām fī Al Islam*, p. 252

Furthermore, in the first constitution in Madinah of 622 BC²¹⁷, there were codified references to insurance replying upon practices such as *al-diyah* and *al-'āqila* (wergild or blood money to rescue an accused in accidental killings), *fidyah* (ransom of prisoners of war) and cooperative schemes to aid the needy, ill and poor.²¹⁸

According to Rusni,²¹⁹ the Madinah Charter incorporated provisions relating to “Social insurance” which can be seen in three forms. The first one is in relation to the payment of *diyah* (blood money) which is to be paid collectively by the *'āqilah* of the killer to the heirs of the deceased. It was stated in article 5 of the said constitution as follows: “The emigrants from Quraysh shall be responsible for their ward and they shall, according to their former approved practice, jointly pay the blood money in mutual collaboration”.²²⁰

The second form of social insurance is the payment of *fidyah*. The purpose of this provision is to rescue prisoners of war, their freedom is paid for by their *'āqilah*. Article 5 of the above constitution further mentioned that “... and every group shall secure the release of their prisoners by paying the ransom. Moreover, the deal among the believers shall be in accordance with the recognised principles of law and justice”.²²¹

²¹⁷ This is the first constitution prepared by the Prophet (S.A.W.) after his migration to Madinah. It was meant for all people in Madinah including the Muslims (*Muhajirūn* and *Anṣār*), the Jews and the Christians. Rusni (2011). *Islamic Banking and Takāful*, p. 258

²¹⁸ Farooq, S.U., Chaudhry, T.S., Fakhr-e-Alam and Ahmad, G. (2010). *An Analytical Study of the Potential of Takāful Companies*, p.56

²¹⁹ Rusni (2011). *Islamic Banking and Takāful*, p. 258

²²⁰ The Constitution of Medina, retrieved on 19th April 2016 from <http://www.constitutionofmadina.com/blog/2012/02/22/constitution-of-medina-in-63-articles/#more-102>

²²¹ The Constitution of Medina, article. 5, retrieved on 19th April 2016 from <http://www.constitutionofmadina.com/blog/2012/02/22/constitution-of-medina-in-63-articles/#more-102>

Third, the provision also mentioned about social assistance for the needy and poor. Article 4-20a of the constitution provides that: “The society shall be responsible to establish a joint venture with a mutual understanding towards providing necessary aid and help to the needy, ill and poor”.²²²

Based on the above particulars, we conclude that that current Islamic insurance system is originated from customs practiced in pre-Islamic and Islamic periods such as *h̄ilf* (حلف), *‘āqilah* (عاقلة), *diyah* (دية) and *fiḍyah* (فدية) with strong evidences for mutual assistance and social responsibility from *Al-Qur’an*, *Al-Sunnah*, and legal maxim. It is important to mention here that the mutual assistance was not originally a commercial transaction and did not contain any profit or gain at the expense of others. Rather it evolved as a useful social practice to mitigate the burden of an individual by dividing it among the members. The current Takāful concept and practice is in fact a hybrid of a mutual and commercial insurer. In principle it needs to move more towards a pure mutual structure.

3.2.2.3 Period of ‘Umar bin Al Khaṭṭāb

In the period of *al Khulafā’ al Rāshidūn*, particularly *Umar bin Al Khaṭṭāb*, the second Caliph of Islam (ruled 634-644), directed all districts of the state to list the names of the Muslim brothers-in-arms²²³ and the people who owed each other to contribute blood money in the event of any manslaughter committed by anyone of their own tribe.²²⁴

²²² Rusni (2011). *Islamic Banking and Takāful*, p. 258

²²³ *Ibn Sa’d, Al Ṭabaqāt al Kubra, Dār Ṣādir*, Beirut, Vol. 3, pp. 300 and 301 as cited Ali, M.S., (2005).

Sīrah Amīr al Mu’minīn Umar bin al Khaṭṭāb Shakhṣiyyatuh wa ‘aṣruh, p. 260

²²⁴ INCEIF (2012). *Takāful – Realities and Challenges*, p. 56

Dīwān of Mujāhidīn was established in various districts whereby those whose names were recorded in the *diwan* owed each other mutual cooperation in which they had to contribute the blood money for killing committed by someone from their own tribes.²²⁵

In this way, the application of the doctrine of *al 'āqilah* was further developed in the Caliphate of Umar, in which elements of insurance practice were also adopted.

3.2.2.4 Period of 'Umar bin 'Abd al Azīz

'Umar bin 'Abd al Azīz is widely considered the fifth orthodox Caliph in Islam for the magnificent service he rendered to people as well as his gentleness, kindness, and generous treatment to everyone reside within the Islamic domain during his rule which lasted only two and half years.

His sublime services which are relevant to this research are:

- a. He has allocated allowances from the *Bait al Māl* i.e. government treasury in order to support those who are in need. For example, he used to appoint a leader to every blind person and a servant to the disable and support those who cannot afford to get married to marry.
- b. He has initiated a house called *Dār al Ṭa'ām* (دار الطعام) or house of food where poor, needy and wayfarer can go and eat free.
- c. He treated *Ahl al Dhimmah* (أهل الذمة) with leniency, kindness and justice, and he used to command his governors to do so.

²²⁵ Rusni (2011). *Islamic Banking and Takāful*, p. 258

- d. He has allocated special allowance from the *Bait al-Māl* for the aged people among the *Ahl al Dhimmah* who reside within the Islamic control zone and does not have someone to take care of him.²²⁶

3.2.2.5 Modern Period

Islamic insurance was first established in the early second century of the Islamic era. This was the time when Muslim Arabs started to expand their trade to India, Malay Archipelago and other countries in Asia. Due to long journeys/voyages, they often had to incur huge losses because of mishaps and misfortunes or robberies along the way. Based on the Islamic principle of mutual help and cooperation in good and virtuous acts, they got together and mutually agreed to contribute to a fund before they started their long journey. The fund was used to compensate anyone in the group who suffered losses through any mishap. The Europeans copied this, which was later known as marine insurance.²²⁷

By the end of the 8th century C.E., the Muslims had developed marine science, marine navigation and built a strong naval unit in the Mediterranean. According to Hitti,²²⁸ Abd al-Rahman III (ruled 912-961), the famous Spanish Umayyad ruler, was the founder of the Muslim navy in Al-Andalus. It was during this time that the merchants of Muslim Spain felt the need for Takāful to cover their losses due to perils of the sea. Based on the principle of ‘helping one another’ they contributed to a fund prior to starting their

²²⁶ Muhammad, A.R., (2006). Theory and application of Islamic insurance in Malaysia and Sudan – A comparative study (Unpublished PhD thesis of University of Malaya), pp.245-247 and Yusuf al Qardawi

²²⁷ Saaty, A.S. and Ansari, Z.A., Takāful – An Islamic Way of Insurance - Developments, Growth, Challenges and Issues, p. 3

²²⁸ Hitti, P.K. (2002). History of Arabs: From the earliest times to the present (Revised 10th edition), in: INCEIF (2012). Takāful – Realities and Challenges, p. 56

voyage and used it to compensate any of them who incurred losses. This way the start of marine Takāful, which of course has been much modified today.²²⁹

However, efforts towards the establishment of *Sharī'ah* compliant insurance providers might have been initiated since the early 20th century, concurrent with a series of *fatwā* (فتوى), legal rulings issued on the impermissibility of commercial insurance as well as the legitimacy of mutual or cooperative insurance. In fact, the latter *fatwā* tend to reflect the vision of the Muslim scholars to see the establishment of Islamic insurance providers based on mutual or cooperative principles. Despite the fact that the above *fatwā* have been issued since as earlier as 1961,²³⁰ the institutionalisation of Islamic insurance based on the above principle only materialised in the late 1970s.

In 1979, the first Islamic insurance institution called the Islamic Insurance Company was finally established in Sudan by the Faisal Islamic Bank. It was designed in accordance with the cooperative principle and aimed to replace the conventional insurance system, which is judged to be invalid by the Sudanese scholars. In the same year, the second Islamic insurance provider called the Islamic Arab Insurance Company was established in Saudi Arabia. This was subsequently followed by the establishment the Islamic Arab Company of United Arab Emirates (UAE) in 1980. *Dār al-Māl Islāmi* in Geneva (1981), *Sharikah Takāful al-Islamiyyah* in Bahrain (1983), Islamic Takāful and Retakāful Company in Bahamas (1983), Islamic Takāful Company in Luxembourg (1983), Al-Barakah Islamic Company in Sudan (1984) and Syarikat Takāful Malaysia Berhad in Malaysia (1984).

²²⁹ INCEIF (2012). Takāful – Realities and Challenges, p. 57

²³⁰ In 1961, Muhammad Yusuf Musa, Professor of *Sharī'ah*, in his response to a question regarding the legal states of insurance contract maintains its permissibility provided that it is built upon the principle of cooperation. See al-Qurrah Daghi, p.153

Later in December 1985, a resolution was made by the council of the Islamic Fiqh Academy under the auspices of the Organisation of Islamic Conference (OIC) to call upon all its members to participate in the establishment of cooperative insurance initiatives as well as cooperative reinsurance as alternatives to the commercial insurers and reinsurers respectively. The above resolution was preceded by other two resolutions that reaffirm the previous *fatwā* made by other authoritative bodies on the prohibition of commercial insurance and the approval of cooperative insurance. These resolutions which took place in the second meeting of the academy are regarded as one of the most significant events in the history of Islamic insurance, since it marked the beginning of a joint effort among the Muslim countries to establish Islamic insurance institutions on a global basis.²³¹ In the subsequent years, Islamic insurance companies became established in many parts of the world. According to the World Islamic Insurance Directory 2011, there are more than 190 Islamic insurance entities operating in 34 different countries.²³²

²³¹ Kamaruzaman bin Noordin in his unpublished PhD thesis titled 'The commercialisation of Islamic insurance (Takāful): a critical study of Takāful business models in Malaysia', p.53

²³² World Islamic Insurance Directory (2011) TakāfulRe Limited

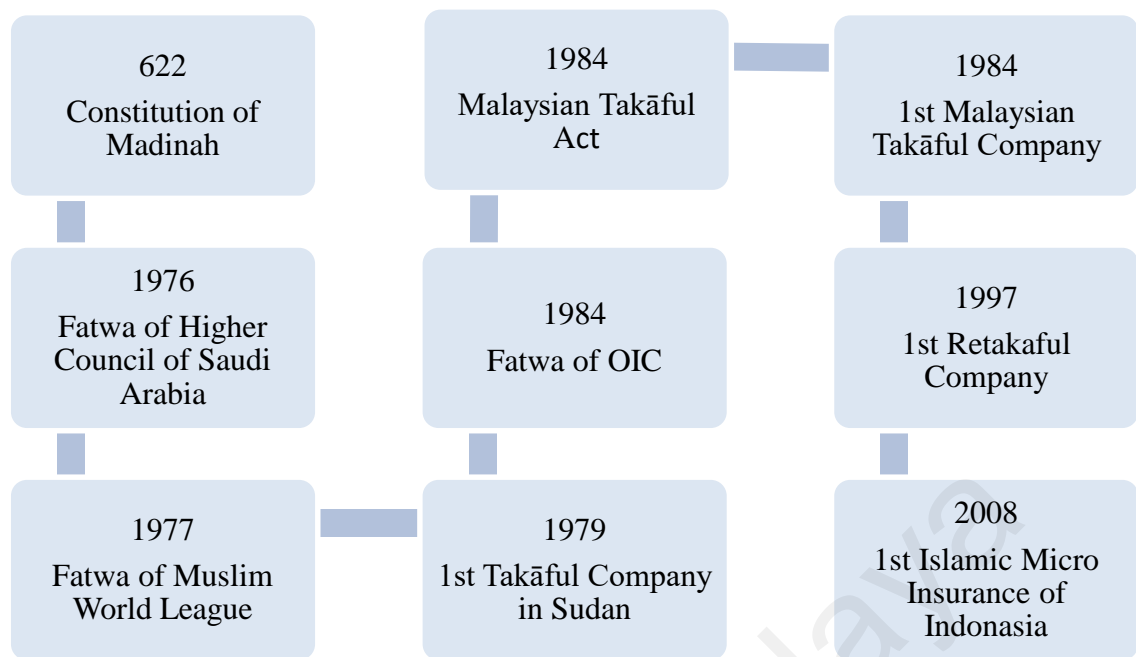


Figure 3.1: Timeline of Takāful

3.2.3 Importance and Significance

Islamic *Sharī'ah* intends to save human beings from hardship. The Holy *Qur'an* says in numerous places. For an example:

يُرِيدُ اللَّهُ بِكُمُ الْيُسْرَ وَلَا يُرِيدُ بِكُمُ الْعُسْرَ

“Allah intends for you ease, and He does not want to make things difficult for you.”²³³

Further He says,

يُرِيدُ اللَّهُ أَنْ يُخَفِّفَ عَنْكُمْ وَخُلِقَ الْإِنْسَانُ ضَعِيفًا

“Allah wishes to lighten (the burden) for you, and man was created weak.”²³⁴

²³³*Al-Qura'n, Sūrah al-Baqarah* (2), 185

²³⁴*Al-Qura'n, Sūrah al-Nisā'* (4), 28

The cooperation and mutual assistance are well emphasised by premier sources of Islam, *Al-Qur'an* and *Al-hadīth*. For an instant,

وَتَعَاوَنُوا عَلَى الْبِرِّ وَالتَّقْوَىٰ وَلَا تَعَاوَنُوا عَلَى الْإِثْمِ وَالْعُدْوَانِ

“Help one another in furthering virtue and God-consciousness (*Taqwa*) and do not help one another in furthering evil and enmity.”²³⁵

مَنْ نَفَسَ عَنْ مُؤْمِنٍ كُرْبَةً مِنْ كُرْبِ الدُّنْيَا نَفَسَ اللَّهُ عَنْهُ كُرْبَةً مِنْ كُرْبِ يَوْمِ الْقِيَامَةِ وَمَنْ يَسَّرَ عَلَىٰ مُعْسِرٍ يَسَّرَ اللَّهُ عَلَيْهِ فِي الدُّنْيَا وَالْآخِرَةِ وَمَنْ سَتَرَ مُسْلِمًا سَتَرَهُ اللَّهُ فِي الدُّنْيَا وَالْآخِرَةِ وَاللَّهُ فِي عَوْنِ الْعَبْدِ مَا كَانَ الْعَبْدُ فِي عَوْنِ أَخِيهِ.. ۞

“He who relieves a believer from one of the world’s grieves, God relieves him from one of the doomsday’s grieves; he who facilitates the life of someone in trouble, God facilitates his life in the world and in the after world; he who protects a Muslim God protects him in the world and in the after world and God helps the man as long as the man helps his brother...”²³⁶

وأيما أهل عرصة أصبح فيهم امرؤ جائع فقد برئت منهم ذمة الله تعالى

“...and any residents of a quarter have among them a hungry person by reason of poverty, Allah is quit of any obligation towards them.”²³⁷

Islam encourages Muslims to be one *Ummah* in every aspect of their lives without creating divisions within the society. The final Prophet (PBUH) reveals:

مَثَلُ الْمُؤْمِنِينَ فِي تَوَادِهِمْ وَتَرَاحِمِهِمْ وَتَعَاطُفِهِمْ مَثَلُ الْجَسَدِ إِذَا اشْتَكَى مِنْهُ عُضْوٌ تَدَاعَىٰ لَهُ سَائِرُ الْجَسَدِ بِالسَّهَرِ وَالْحَمَىٰ

²³⁵ *Al-Qura'n, Sūrah al-Mā'idah* (5), 2

²³⁶ *Muslim*:7028, *Aḥmad*:7421, *Abū Dāūd*:4948

²³⁷ *Musnad Aḥmad*:4880, vol:2, p.33

“The believers, in their mutual affection, mercy and sympathy to each other, are like the body; if one of its organs suffers and complains, the rest of the body responds with insomnia and fever.”²³⁸

He further describes that the *Mu'mins* are just like a building and strengthen each other.

إِنَّ الْمُؤْمِنَ لِلْمُؤْمِنِ كَالْبُنْيَانِ يَشُدُّ بَعْضُهُ بَعْضًا وَشَبَّكَ أَصَابِعَهُ

“A *Mu'min* to another *Mu'min* is like a building structure that tightens and reinforce each other. He interlaced his fingers.”²³⁹

As Maysami and Kwon²⁴⁰ describe that Takāful insurance refers to an Islamic way of joint guarantee in which a group of societal members pool their financial resources together against certain loss exposures. In particular, Takāful life insurance works both as (1) a savings instrument where participants set their own target amount to accumulate over a certain period, and as (2) a protection mechanism in which all participants guarantee each other against certain events that would alter their financial status. In contrast, Takāful non-life insurance works more like a joint guarantee in which all participants contribute their own shares of premiums into a pool and mutually agree to indemnify those participants who suffer from an insured peril. Muslim jurists generally agree that Takāful insurance is accordant with the *Sharī'ah*, as *ḥalāl* concepts of *tabarru'*²⁴¹ (meaning ‘donation’ or ‘contribution’) and Takāful (meaning ‘joint venture’ or ‘shared responsibility’) are deeply embedded in it.

²³⁸ *Muslim*: 6751, *Aḥmad*: 18398 and 18404

²³⁹ *Al-Bukhāri*: 481 & 6026 and *Muslim*: 6750

²⁴⁰ Maysami, R.C. and Kwon, W.J., *An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism*, p.7

²⁴¹ The concept of *tabarru'* is the pillar under the system of Takāful which renders the element of uncertainty in a contract irrelevant. *Sharī'ah* allows that a donation may be restricted by or subjected to certain terms and conditions, and its amount may be allocated for a specific purpose. The act of making donation that is tied to a contingency upon certain conditions is pronounced in the Financial Accounting Standard No. 13 of AAOIFI states: “The underlying concept of *tabarru'* in Takāful contract is different from the literal understanding of *hibah* (gift) or *ṣadaqah* (donation). As spelt out in the standard the *tabarru'* is actually a commitment to donate (*iltizām bi al tabarru'*) with a condition of compensation.”

3.2.4 Characteristics of Takāful

Takāful insurers have unique characteristics that recognise the key principles of Takāful and fundamental Islamic beliefs.

1. **The establishment of two separate funds:** A Takāful (or policyholders’) fund and an operator’s (or shareholders’) fund. The Takāful fund operates under pure cooperative principles, in a very similar way to conventional mutual insurance entities. Underwriting deficits and surpluses are accrued over time within this fund, to which the operator has no direct recourse. As a result, the Takāful fund effectively is ring fenced and protected from default of the operator’s fund. Management expenses and seed capital are borne by the operator’s fund, where the main income takes the form of either a predefined management fee (to cover costs) or a share of investment returns and underwriting results (or a combination of both).
2. **Solidarity principle and equal surplus distribution:** Given that the Takāful fund is seen as a pool of risks managed under solidarity principles, it is not meant to accumulate surpluses at levels excessively higher than those strictly needed to protect the fund from volatile results and to support further growth. Likewise, any fees or profit shares received by the operator should be just sufficient to cover management and capital cost while keeping the company running as an ongoing concern. In case of financial distress for the Takāful fund, the operator is committed to provide it with an interest free loan, *Qard Hasan*, for however long it is deemed necessary – providing an additional layer of financial security to the participants. The surplus distribution structure is expected to be managed carefully and in a balanced way, so that neither policyholders nor operator make excessive profits at the expense of the other party.

3. **Restricted Investments:** *Sharī'ah* compliance refers not only to the operational structure of the company, but also to its investment policy. Takāful companies must avoid investing in traditional fixed – income securities (due to the coupon interest payment attached). Instead, they are allowed to invest in *Sukūk* (or Islamic bonds, where coupon payments take the form of a profit share on a particular enterprise). Moreover, investments in stocks (in principle allowed) should avoid activities (such as alcohol or gambling).

4. **Establishment of a *Sharī'ah* Board:** An essential component in a Takāful company's corporate governance is the establishment of a *Sharī'ah* board, in addition to the conventional board of directors. The *Sharī'ah* board is made up of recognised Muslim scholars, who ensure the company's operational model, profit distribution policies, product design and investment guidelines comply with Islamic principles.²⁴²

3.2.5 Takāful and Conventional Insurance

Both the conventional economy and the Islamic principles accept the idea of insurance as a mutual financial transaction aimed at safeguarding a person against an unexpected material risk despite both systems operating through different methods.²⁴³ The differences between the two methods can be evaluated through various viewpoints. In this section, Islamic and conventional insurance are compared on the basis of concepts and practices.

²⁴² Saaty, A.S. and Ansari, Z.A., *Takāful – An Islamic Way of Insurance - Developments, Growth, Challenges and Issues*, p. 4

²⁴³ Billah, M.M., *Islamic Insurance (Takāful)*, p. 1.

3.2.5.1 Governing Rules and Regulations

The governing rules and regulations of the Takāful principles have their roots in *Sharī'ah* the revealed knowledge i.e. sacred orders of Allah in *Al-Qur'an*, religious, social, and commercial practices of the Holy Prophet (PBUH), *Ijmā'* (the agreement of whole Islamic world on an issue) and *Qiyās* (comparative arguments), form the basis of *Sharī'ah*. *Sharī'ah* is the constitution of the Islamic world. According to Islam, the basic principles of *Sharī'ah* are necessary for an action to be approved religiously.

Other than those four basic sources of Islamic *Sharī'ah*, other sources could be used as further justification for an idea or a practice of Takāful insurance, so long as they do not contravene the sanctions of the Holy *Al-Qur'an* nor the *Al-Sunnah* of the Holy Prophet (PBUH). *Qawl al-Ṣaḥābah* (statements and practices of companions of the Prophet (PBUH), *Al-Maṣlahah al-Mursalah* (public interest) and *Al-'Urf* (custom, practice or usage of the community) are the examples for this category of sources. Moreover, the opinions and interpretations of *Al-Qur'an* and *Al-Sunnah* from prominent Muslim *Sharī'ah* scholars are also considered in this regard.²⁴⁴

In the conventional insurance system, rules and regulations are made according to human thinking. Currently, most of the rules implemented in the insurance world are driven from western philosophy based on materialism and secularism. The sources of insurance law are mainly the Acts of parliament, judicial precedents, custom and so on. Based on this idea, there are regulatory institutions in almost all countries in the world.

²⁴⁴ For detail, see: Yassin and Ramly (2011). Takāful: A study Guide, pp. 05-20 and INCEIF (2012). Takāful – Realities and Challenges, pp.78-92

3.2.5.2 Goal

The goal of conventional insurance is to maximise profit in favour of shareholders because they are stock companies and based solely on commercial factors. In contrast, Takāful's goal is wellbeing and self-sustaining operation without giving the first preference to earn high profit by the insurance transactions. In other words, the participants get insurance coverage and profit by pooling their contributions. The Takāful company acts as facilitator for participants to achieve their targets. Billah²⁴⁵ stated that Islamic insurance is a policy of joint guarantee, which aims at achieving the pleasure of Allah (SWT) through the concept of mutual help and cooperation in providing material security for the insured against an occurrence of an unexpected peril or loss.

The main purpose of Takāful under the Islamic system is to bring equity to all parties involved, and the objective of the contract is to help the policyholders through bad times. Profit earning is not the main goal, while sharing any profit generated is acceptable but the conventional system aims to earn profit.

The aims of Takāful are further highlighted by the Malaysian Takāful Act 1984 as follows:

A scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose.²⁴⁶

According to Sudin and Wan Nursofiza,²⁴⁷ the philosophy of Islamic insurance places importance on sincerity of intention to assist one another. Thus, the financial

²⁴⁵ Billah, M.M., *Islamic Insurance (Takāful)*, p. 7.

²⁴⁶ Malaysian Takāful Act, 1984, S.2.

²⁴⁷ Haron, S. and Azmi, W.N.W., *Islamic Finance and Banking System – Philosophies, Principles & Practices*, p. 437.

contribution for this purpose is based on the spirit and the principles of mutual responsibility, cooperation, and protection and confirming to the qualities of selflessness and not being driven towards mere acquisition of profit.

3.2.5.3 Risk Transfer/Sharing

The conceptual difference between Takāful and conventional insurance is that risk distribution in Takāful is not exchanged by way of contribution payments made to operator which means operator is not selling and participant is not buying any risk coverage. Operator is playing the role of fund manager on behalf of the participant. So operator is not undertaking risk, the risk is however, distributed among the participants who agreed to jointly assume the risk.²⁴⁸

Under conventional framework Insurance is a contract between two parties, whereby first party agrees to undertake the risk of other party in exchange of premium and the other party promises to pay fixed sum of money to the first party on the happening of uncertain event with in a specific duration.²⁴⁹

3.2.5.4 Ownership

Takāful fund is managed by operator but ownership is of participants. They have a complete right of contribution and benefits. In conventional insurance the policyholder

²⁴⁸ Mher Mushtaq Hussain and Ahmad Tisman Pasha, Conceptual and Operational Differences between General Takāful and Conventional Insurance, Australian Journal of Business and Management Research, Vol.1 No. 8, November- 2011, p. 25

²⁴⁹ Spence and Zeckhauser, (1971) as quoted in Mher Mushtaq Hussain and Ahmad Tisman Pasha, Conceptual and Operational Differences between General Takāful and Conventional Insurance, Australian Journal of Business and Management Research, Vol.1 No. 8, November- 2011, p. 25

purchase policy and there exist seller – purchaser relationship. Takāful company performs trustee and operator functions. In conventional insurance there exists a one to one relationship between policy holder and company.

Under Takāful, the policyholder's funds belong to the policyholders on a collective basis and are managed by the shareholders. Under the conventional scheme, all funds belong to the company.²⁵⁰

3.2.5.5 Monitoring Committee

In Takāful companies, having a *Sharī'ah* supervisory committee is mandatory. This supervisory board functions as the supervisor of the Islamic insurance activities run by the particular company, to ensure that all these insurance activities operate in accordance with the divine principles.²⁵¹ Their role is to review the operations, supervise its development of *Sharī'ah* insurance products, and determine the *Sharī'ah* compliance of these products and the investments. The *Sharī'ah* supervisory board have to perform their own independent audit and certify that nothing relating to any of the operations involve any element prohibited by *Sharī'ah*. A *Sharī'ah* supervisory council for every individual Takāful operator is a prerequisite prior to the commencement of the Takāful operation. The *Sharī'ah* standards for Islamic financial institutions of AAOIFI reveal that a *Sharī'ah* supervisory board should be formulated for insurance of *fatāwa* (plural of *fatwā* i.e. legal opinion) that are binding to the company, and establishment of an internal unit for *Sharī'ah* monitoring and auditing.²⁵²

²⁵⁰ For more details, see: Mher Mushtaq Hussain and Ahmad Tisman Pasha, Conceptual and Operational Differences between General Takāful and Conventional Insurance, Australian Journal of Business and Management Research, Vol.1 No. 8, November- 2011, pp. 26 and 27

²⁵¹ Billah, M.M. (2003). Islamic and Modern Insurance – Principles and Practices, p. 50

²⁵² AAOIFI, *Sharī'ah* Standards for Islamic Financial Institutions, (2008), No: 26, 5/9, p. 473.

While in conventional insurance there is no such *Sharī'ah* supervisory committee to monitor the activities of the company.

3.2.5.6 Unlawful Elements

Different elements like *Ribā* (interest), *gharar* (uncertainty), and *Maysir* (gambling) are involved in conventional insurance. For instance, in non-life policies if a policyholder does not make a claim, his insurance company keeps the whole amount. If he/she cancels the policy contract also loses all premiums which he/she has deposited. Likewise, if the insurance company terminates its activities, the policyholders will be refunded proportionally.

The uncertainty is also observable in the conventional insurance. The premium payment from the policyholder is certain but is uncertain from the shareholders or the company. The benefits to be paid depend on the outcome of future events not known at the time of contract. To eliminate the element of uncertainty in the Takāful contract, the concept of *Tabarru'* (to donate or give away) is incorporated. A participant agrees to relinquish as *Tabarru'* certain proportion of his Takāful instalments or contributions he agrees or undertakes to pay thus enabling him to fulfil his obligation of mutual help and joint guarantee, should any of his fellow participants suffer a defined loss. In Takāful, the element of uncertainty is eliminated as subscription and compensation is concerned.

There are some features similar to gambling in conventional insurance. The policyholder pays his premium, he/she might get a very big amount if the losses indicated in the policy occurred, if not he/she will lose all the premiums paid. It works by mere

chance, speculation, and conjecture and not from work, taking responsibility, or real sector business.²⁵³

The nature of the principles of Takāful differs from the conventional insurance because all the operations in Takāful are in line with the *Sharīʿah* principles. The operation of Takāful is based on the principle of *Al- Muḍārabah* which is profit and loss sharing techniques which is alternative to interest (*Ribā*) in conventional insurance.

The majority of Muslim scholars have generally decided that the practice and operation of conventional insurance as currently practiced do not fulfil the rules and requirements of *Sharīʿah*. Therefore, in June 1972 the Malaysian National *Fatwā* Council resolved that the present day life insurance as provided by the conventional insurance companies was not in line with the principles of *Sharīʿah*.²⁵⁴ Similarly, in a comprehensive deliberation, the first international conference for the Islamic economy held in Makkah in 1976, the Higher Council of Saudi *ʿUlamas* in 1977, the *Fiqh* Council of The Muslim World League in 1978²⁵⁵ and the *Fiqh* Academy of the Organisation of Islamic Conference (OIC), at gathering in December 1985, resolved that no form of insurance, life or general, conformed to Islamic principles and therefore it was *ḥarām* (prohibited).²⁵⁶

²⁵³ For more details, see: Mher Mushtaq Hussain and Ahmad Tisman Pasha, Conceptual and Operational Differences between General Takāful and Conventional Insurance, Australian Journal of Business and Management Research, Vol.1 No. 8, November- 2011, pp. 25 & 26 and Ali, E.R.A.E. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp. 7-21

²⁵⁴ Ali, E.R.A.E. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 08.

²⁵⁵ Encyclopedia of Islamic Banking and Insurance (2006). p. 200.

²⁵⁶ Ali, E.R.A.E. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 08.

3.2.5.7 Operation

Mahmood²⁵⁷ said, *Shari'ah*-compliant insurance is based on principles of mutual cooperation (*Ta'āwun*) and donation (*Tabarru'*), where the risk is shared collectively and voluntarily by the group of participants. It is derived from an Arabic word meaning 'joint guarantee' or 'guaranteeing each other'. According to Nik Ramlah Mahmood,²⁵⁸ *Takāful* is characterised by three aspects of mutuality, namely, mutual help, mutual responsibility and mutual protection from losses. The "insurance" that is provided is not dispensed by one party (the insurer) to another (the insured). The person seeking protection participates in a scheme of co-operation with other participants to mutually insure one another. The company that runs the scheme is not the insurer but is merely an institution which provides the entrepreneurial and administrative skills required to bring the participants together, to collect and invest the contributions and to process the claims. Obaidullah²⁵⁹ said donations from all participants are accumulated into a common fund called *tabarru'* fund' or 'risk fund', from which compensation or indemnification is paid to participants suffering a defined loss.

Accordingly, the clause of *Tabarru'* is incorporated in the contract. The element of *tabarru'* makes it no longer a contract of exchange but instead a contract of cooperation and mutual help where uncertainty is no more relevant.²⁶⁰ Both the accounts (donations for meeting 'moral liability' or losses of the fellow policyholders and the other part fro

²⁵⁷ Mahmood, 'Insurance: Takāful Gaining Ground, the Actuary'. 2008, as quoted by Asif Ahmed Qureshi, 'Analyzing the *Shari'ah* compliant issues currently faced by Islamic Insurance', *Interdisciplinary Journal of Contemporary Research in Business* Copy Right © 2011 Institute of Interdisciplinary Business Research, Vol. 3, No. 5. (September 2011, available at www.ijcrb.webs.com, accessed on 17th December 2011), 281, 282.

²⁵⁸ Nik Ramlah Mahmood, 'Takāful: the Islamic system of mutual Insurance – The Malaysian Experience', *Arab Law Quarterly*, vol. 6, No. 3 (Brill publishers.1991), 286.

²⁵⁹ Obaidullah, *Islamic Financial Services*, [[http:// www.islamic-finance.net](http://www.islamic-finance.net)], 2005 as quoted by Asif Ahmed Qureshi, *Analyzing the Shari'ah* ..., 281, 282.

²⁶⁰ Yusof, M.F., Ismail, W.Z.W. and Naaim, A.K.M. (2011). *Fundamentals of Takāful*, p. 18

investment) are invested in *Sharī'ah* compliant investments and returns thereof distributed on *Muḍārabah* principle between the participants and the Takāful operators.²⁶¹ The profit attributable to the participants is credited into the two accounts.

Conventional insurance operates in such a way that premium is paid by policy holders to the insurance company and then this amount is invested by insurance company in interest bearing or non-*Sharī'ah* compliant investing areas. Amount of interest and profit is received by insurance companies and then surplus is retained in the company without distributing it among policy holders and only claims are met with this surplus. Takāful operates on mutual assistance, while conventional insurance operates on business principles.

3.2.5.8 Contract

The insurance contract as practiced by conventional insurance is a contract of exchange where the insured pays the premium to the insurer in exchange for the promise to indemnify by the insurer in the event of a loss. However, according to scholars, the conventional insurance contract, as a business transaction, does not fulfil the characteristics of a contract of exchange in Islam which renders the contract invalid and void and therefore *ḥarām*.²⁶²

Insurance in Islam is based on the system of shared responsibility, cooperation and mutual help as founded in the concept of Takāful, which simply means joint-guarantee. Takāful can thus be visualized as a pact between a group of members or

²⁶¹ Farooq, S.U., Chaudhry, T.S., Fakh-r-e-Alam and Ahmad, G. (2010). An Analytical Study of the Potential of Takāful Companies, p.58

²⁶² Yusof, M.F., Ismail, W.Z.W. and Naaim, A.K.M. (2011). Fundamentals of Takāful, p. 17

participants agreeing to jointly guarantee one another in the event of a loss due to a catastrophe of misfortune.²⁶³

Under a Takāful contract, every policyholder has the right to know how their money is used, how the surrender value is calculated, and Takāful policyholders must be certain that neither returns nor funds paid out in claim settlements, originate from unlawful means such as investments in stocks of companies producing non-*ḥalāl* goods but in conventional insurance policyholder have no right to know this.

3.2.5.9 Investment

The contract of Takāful provides solidarity in respect of any tragedy in human life and loss to the business or property. The policyholders (Takāful partners) pay subscriptions to assist and indemnify each other and share the profits earned from business conducted by the company with the subscribed funds.²⁶⁴ The distinction between the conventional insurance and Takāful business is more visible with respect to investment of funds. While insurance companies invest their funds in interest-based avenues and without any regard for the concept of *Ḥalāl* or *Ḥarām*. Takāful companies undertake only *Shari'ah* compliant business and the profits are distributed in accordance with the initially agreed ratios in the Takāful contract. Likewise they share in any surplus or loss from the pool collectively. Takāful system has a built-in mechanism to counter any over-pricing policies of the insurance companies, because whatever premium

²⁶³ *Ibid*, p. 55

²⁶⁴ Ayub, M. (2003). An introduction to Takaful – an alternative to insurance. Islamic Banking Department, State Bank of Pakistan, Karachi. p.3.

charged, the surplus would normally go back to the participants in proportion to their contributions.²⁶⁵

From a different perspective, a Takāful contract may comprise clauses for either protection or savings/investments or both the benefits of protection as well as savings and investment. The protection part of Takāful works on the donation principle according to which individual rights are given up to indemnify the losses reciprocally. In the savings part, individual rights remain intact under *Muḍārabah* principle and the contributions along with profit (net of expenses) are paid to the policyholders at the end of policy term or before, if required by him.

As regards the investments of the paid premiums, the company (insurer) is under an obligation to invest the paid premiums in a lawful business free from the elements of *Ribā*, gambling and other forms of unlawful transactions which are contrary to the divine principles.²⁶⁶ In addition to that the governments of the countries in which Muslims are in majority have introduced a legal framework which helps in introduction of new *Sharī'ah* compliant products. *Muḍārabah* certificates are the instruments which are evolved from such legal framework. While a conventional insurance company invests in interest based instruments like treasury bills, certificates of deposits, interest bearing bonds, gambling institutions. Also, the funds can be invested in any scheme or project, which may not be supported by the *Sharī'ah* discipline like businesses that make alcohol, pork, businesses that sell weapons, drugs, and businesses connected to prostitution.

²⁶⁵ Farooq, S.U., Chaudhry, T.S., Fakhr-e-Alam and Ahmad, G. (2010). An Analytical Study of the Potential of Takāful Companies, p.58

²⁶⁶ Billah, M.M. (2003). Islamic Insurance (Takāful), p. 54.

3.2.5.10 Surplus²⁶⁷

Insurance surplus is one of the main pillars and prominent characteristics of Islamic insurance companies adopted as the core of cooperative insurance based on policyholder's donation and rights.

It²⁶⁸ is distributed among the insured parties because only they have the right to it while the shareholders have no right to it. A basic difference between Islamic insurance and commercial (traditional) insurance is limiting insurance surplus to the insured parties and limiting its investment to lawful Islamic means. In commercial insurance companies, the shareholders, and not the insured parties, have the right to the insurance surplus. Moreover, commercial insurance companies do not always consider using Islamic lawful methods when investing the insurance surplus.²⁶⁹

Takāful differs from conventional insurance in the sense that the company manages and employs the funds for investment, business and administration on behalf of the participants. Profits attributed to the participants' funds are shared between the Takāful company and the participants according to an agreed formula. In case of insurance, the premium funds become property of the company and any profits or losses go to the company's account.

²⁶⁷ Surplus is the remaining amount of money in the insured parties' account. It includes the sum of their paid premiums and their investments after deducting the payments due to them, payment of claims, reinsurance expenses, and paying of fees due to the operator as well as monitoring technical reserves.

²⁶⁸ It is the remaining balance in the Takāful fund (at the end of a financial year), taking into account contributions collected from participants and income generated from investing them, and the obligations due to be settled, e.g., payment of claims and/or benefits, costs of retakāful and other relevant expenses. As Hamim Syahrūm, A.M., Izwayu, A.A. and Noraziyah, M.H., mentioned in their article 'Surplus-sharing Practices of Takāful Operators in Malaysia, p. 103.

²⁶⁹ Sabbagh, A.M. (2010). Insurance Surplus in Islamic Insurance Company, p.1

3.2.5.11 Forfeiture²⁷⁰

In an insurance contract there is clause that the insurer can forfeit the premium amount that is paid by the policy holders under certain circumstances. *Islam* does not allow the forfeiture of premium, wholly or partly, as the amount of premium is considered as loan by insured to insurer. In Takāful there is no forfeiture of contributions and it is distributed among the participants in form of surplus. If the holder of an Islamic insurance policy decides to terminate a policy in a manner that is not provided under terms of the contract, premiums are refundable along with any corresponding surrender value less administrative fees, but in conventional insurance insured forfeited his/her premiums on termination of a policy.

3.2.5.12 Encouragement for Goodness

Takāful helps people to accumulate their saving for the goodness of the community. The Holy Prophet (PBUH) said “whosoever removes the hardship from believer, Allah will remove hardship from him one of the hardship of the Day of Judgment”.²⁷¹

The fundamental principle of the Islamic economic system is an equitable distribution of wealth. Takāful is a system where people are encouraged to contribute money for mutual help in times of need. The Islamic economic system combats the accumulation of wealth and its concentration in the hands of a small minority. The Islamic law of inheritance provides for the shifting and distribution of wealth. It divides the estate

²⁷⁰ Forfeiture is the involuntary relinquishment of money or property without compensation as a consequence of a breach or non-performance of some legal obligation or the commission of a crime.

²⁷¹ *Ṣaḥīḥ Muslim*

of the deceased over a wide range of beneficiaries, without benefiting a single heir to the exclusion of all others. The nominee in a family Takāful scheme is only a trustee and the policy money needs to be distributed to all the heirs.²⁷²

The following table briefs the differences between Takāful and conventional insurance:

Table 3.1: Differences between Takāful and Conventional Insurance

Issue	Conven. Insurance	Takāful
Governing rules and regulations	Manmade No religious consideration	<i>Revealed Knowledge (Wahy)</i> , i.e. <i>Al-Qura'n</i> , <i>Al-Hadīth</i> , <i>Ijmā'</i> , <i>Qiyās</i> and Islamic Ethics
Organisational Principle	Profit for shareholders	Mutual for participants
Basis	Risk transfer	Cooperative risk sharing
Laws	Secular/Regulations	<i>Sharī'ah</i> & prudential regulations
Ownership	Shareholders	Participants
Management status	Company management	Operator
Form of contract	Contract of sale	Cooperative, <i>Wakālah</i> or <i>Muḍārabah</i> or <i>Waqf</i> with <i>Tabarru'</i> (contributions)
Responsibility of Policy holders/Participants	Policy holders pay premium to the insurer	*Participants make contribution to the scheme *Participants mutually guarantee each other under the scheme
Investments	No restriction, mostly Interest based, non- <i>Sharī'ah</i> compliant	<i>Sharī'ah</i> compliant, <i>Ribā</i> -free
Profit	Belong to shareholders	Shared between participants and operator based on profit sharing principles
Surplus	Shareholders' Account	Participants' Account
<i>Sharī'ah</i> Council	Not applicable	Obligatory

Source: From the secondary data collected by the researcher

²⁷² Swartz, N.P., and Coetzer, P., *Takāful: An Islamic Insurance...*, 334

3.3 Developments of Takāful

Takāful remains the smallest segment of the Islamic financial services industry (IFSI) despite notable developments in recent years. There were an estimated 113 Takāful Operators in 2006, two-thirds of which are located in the Gulf Cooperation Council (GCC), Far East, and Africa regions. The number increased to 195 as at end-2010 with new operators appearing in the GCC, the Levant and other jurisdictions.²⁷³

Despite its relatively small market share as compared to its banking and capital market counterparts, the industry has witnessed growth since the first operator emerged in Sudan in 1979. In 2010, the global Takāful contributions reached USD8.3 billion. Although the actual to date contribution is subject to uncertainty, the industry estimated the global total contribution to be at USD12 billion in 2012 with an average annual growth of 20%.

Presently, the Takāful market is highly concentrated across countries such as Malaysia and the GCC states. However, there are a number of other jurisdictions, especially across Africa and Central Asia such as Nigeria, Gambia, Kazakhstan and Senegal, where there is growing interest in a *Shari`ah* compliant insurance model. In Asia, between 2008 and 2010 in South-East Asia and Bangladesh the industry showed a CAGR of 32.4% and 27.9%, respectively.²⁷⁴

²⁷³ IFSB (2013). Islamic Financial Services Industry Stability Report, p. 32

²⁷⁴ IFSB (2013). Islamic Financial Services Industry Stability Report. p.32

3.3.1 Spread and Growth

The Muslims worldwide have clearly demonstrated the commitment and the desire to be very much part of the growth and development wish of modern commerce. They have extensively used Islamic alternatives to prevailing conventional financial instruments and practices. Islamic banking is a great success not only in Muslim majority countries but also in Muslim minority countries. Major international banks today offer *Sharī'ah* compliant products. In a similar manner, Takāful presents an Islamic alternative to insurance.²⁷⁵

This Islamic insurance system is being practiced in Muslim countries as well as in countries wherein Muslims live as a minority. Muslims see it as a *Ḥalāl* product while non-Muslims perceive it as a reasonable and ethically superior system. They see that the returns on investments are favourable and market bench marked and that it is not generated from gambling, alcohol, and interest and they feel comfortable with these principles. According to Zainul Abidin,²⁷⁶ an agent for Takāful National Malaysia, Takāful National has 500,000 individual policy holders and 20% of its participants are non-Muslims and they have shown a keen desire to stay with the Takāful brand.

Islamic finance has captured a universe of USD 1 trillion dollars in assets under management, and is growing quick. The industry has captured the attention of most of the financial professionals worldwide. Acknowledged as the fastest growing industry in the world, it comprises of mainly three sectors namely Islamic banking, Islamic capital

²⁷⁵ Khan, M.M., Ahmad, N., Iqbal, M.S. and Ali, S. (2011). Comparative Analysis of Islamic and Prevailing Insurance Practices, p.286

²⁷⁶ *Ḥalāl* Journal, retrieved from www.halaljournal.com/article/.../malaysia-the-leader-in-takaful-indust on 01 June 2012

market and Islamic insurance (Takāful). Although Takāful is the slowest growing segment of the Islamic financial industry, it has generated vast interest among investors and insurance providers.

According to The World Takāful Report released in April 2011, the global Takāful contribution grew 31% by 2011 to reach US\$ 6.9 billion and remain on course to surpass US\$ 11.9 billion by 2011.²⁷⁷ The premium is projected to increase to US\$12.5 billion by 2015 with over US\$30 billion in funds. Interestingly, this figure for 2015 was revised from an earlier similar estimate of \$7.5 billion done in 1999, which in a way indicates that business expectations may be materialising at a faster pace, driven to a large extent by strong market growth in the Gulf region and especially Malaysia. Nowadays, the Takāful industry is populated by 195 operators worldwide. Surprisingly, American Insurance Group (AIG) is the largest Takāful fund operator in the world.²⁷⁸

During the past two decades we have seen Takāful operations opening up in many countries throughout the world, primarily in Muslim countries and countries with a large Muslim community. In the Far East, Malaysia has been at the forefront of Takāful development with Bank Negara taking the lead with the introduction of separate Takāful regulations allowing the Takāful business to flourish in that country. The report by A.M. Best co., Takāful Poised for Growth, But Greater Focus is required, examined eight Takāful operators and 45 conventional insurers in Malaysia, which has established itself as an international financial hub for *Shari'ah* compliant offerings. According to the insurance regulator, Bank Negara Malaysia, general Takāful contributions reached MYR 1.4 billion (USD 454 million) in 2010 while family contributions were MYR 3.3 billion

²⁷⁷ The World Takāful Report, released by Ernst & Young in April 2011, p.6 (B4)

²⁷⁸ Shahrulnizam A. H.M., *Shari'ah* issues in Takāful: A Brief assessment through Literature Review and the opinions of Industry Experts, p.2

(USD 1.1 billion). Singapore, Indonesia, and Brunei have all followed with the development of Takāful operations.

In the Middle East, Takāful operations have developed in Saudi Arabia, Bahrain, Iran, Qatar, and Iran with new operations opening up in Egypt, UAE and Kuwait in recent years. The Takāful growth rate in these countries is well ahead of the conventional insurance market in the region. With regard to Takāful, the market is expected to be worth \$4 billion in the next few years at the present rate of expansion, compared with about \$170 million today. The A.M. Best Co. report shows that Takāful operators in the GCC – the United Arab Emirates (UAE), Bahrain, Saudi Arabia, Oman, Qatar, Kuwait, and Malaysia are growing at a rapid pace and are enjoying strong capitalisation on a consolidated funds basis.

Focusing on Takāful developments in the Middle East region, there is a healthy and growing general Takāful industry. Saudi Arabia leads the way with a number of Takāful operations offering a full range of non-life Takāful products such as motor, health, marine, aviation, property etc. Similar general Takāful products are available from the numerous other Takāful companies operating in this region. Takāful International in Bahrain and Jordan Islamic Insurance, Jordan, are at the forefront of Takāful development in their respective countries.

It is fair to say that the Far East and Middle East regions lead the way in Takāful development, but other countries are moving in this direction especially Bangladesh and Sri Lanka.

Outside these two primary regions, Takāful has also been introduced into Europe and the USA. Interestingly, Takāful arrangements are also found in Luxembourg and Switzerland and, recently, in the US and Australia. Growth is forecast to be rapid after the turn of the century. But, as yet, development of Takāful in the western world has not met with any major degree of success. It is no doubt that there is a tremendous opportunity for Takāful to develop in these regions, with large Muslim communities not being able to avail themselves of Takāful products and services. But significant investment is required to compete with the conventional insurance industry and regulatory changes would be also be necessary, as seen in the Malaysian market, to allow Takāful to compete on equal terms with the conventional insurance operators.

During 2006 and 2007, a significant number of Takāful and retakāful operations were established by major conventional re/insurance players (e.g. Munich Re, HSBC, Hannover Re, Prudential, AIG, Tokio Marine and Swiss Re in 2006; Aviva and Allianz in 2007)

Interestingly, Takāful insurance is observed in the non-Islamic world too. Takāful USA Management Services, LLC (Wayne, NJ) is just one of the several Takāful insurers in the US. Established in 1996, it provides Takāful life and non-life insurance coverages in both personal and commercial lines. Other US Takāful insurers or financial institutions operating under the *Sharī'ah* principles include: Failaka Investments (Chicago, IL), Samad Group (Dayton, OH), North American Islamic Trust (Indianapolis, IN), *Baitul Māl.*, Inc. (Secaucus, NJ), Abar Investments, Inc. (Stamford, CT) and MSI Finance Corporation (Houston, TX).

Analysts revealed that the reasons or factors for this speedy development of Takāful insurance are:

1. Introduction of compulsory covers in many of the countries it operates.
2. Support of respective governments for Takāful operations. For instance, in the GCC and Malaysia appear to support the concept of Takāful offerings, which provide an option for a large part of the population that has previously been unable to purchase certain types of insurance owing to religious beliefs.
3. A consequence of the rapid expansion of the insurance markets in the world, as opposed to increased demand specifically for *Sharī'ah* compliant offerings.
4. Regulatory developments with the introduction of specific Takāful regulation in some countries including in the UAE, Saudi Arabia, Bahrain and Malaysia.
5. Greater recognition among Muslims in recent times that they need to focus more on Islamic principles in their lives.
6. An awareness of the issue created by a large number of conferences on Islamic finance and Takāful around the world.
7. A recent expansion of banks launching Takāful products linked with other Islamic financial products either as bancassurance products or through agency-based sales.
8. In some non-Islamic countries with significant Muslim populations the concept may be introduced by conventional players through Islamic insurance “windows”.
9. The development of other components of Islamic finance such as Islamic banking, Islamic capital market, Islamic bonds has provided a conducive environment for Takāful to grow.
10. Potential of Takāful to attract the non-Muslim community. There is a large number of Takāful customers are non-Muslims in Malaysia, Singapore, Sri Lanka, Bangladesh and in many other countries. Furthermore, many of the non-Muslim agents are now engaged in selling Takāful products.

11. Ensuring maximum benefit for customers at a least cost, because, it gives a share of the surplus back to the policyholders.
12. Competitive pricing of Takāful products compare to the conventional insurance products.

Takāful insurance has the potential to grow rapidly in future years because, Islam is the fastest growing religion and the Muslims constitute likely the first largest religious group in the world. At present there is a greater tendency among the Muslim population to go for religious based solutions to problems they face, be it social, economic, or any other. Furthermore, penetration of insurance in Muslim countries is very low. The same applies to the Muslim population in other non-Muslim countries. One reason is the un-Islamic character of present day insurance system. Any alternative system, which can provide religious comfort to Muslim, therefore Takāful has tremendous potential. And also, Takaful insurance is seen as more ethical, more balanced for all the stakeholders and less exploitative in nature. It is a fairer and more transparent system. In traditional insurance, the premium paid becomes dead expenditure without any corresponding benefit, if there is no claim. Addition to that, in view of the uniqueness of Takāful system, it has the potential to become very popular with non-Muslim masses. Policyholders under this system know upfront the formula and mechanism for profits sharing. Profit sharing is a great attraction for Takāful business.

Moreover, Takāful products are available to meet the needs of all sectors of the economy at corporate and individual levels. There are Takāful exclusive insurance companies operating in many countries and there are traditional insurance companies operating with “Takāful Window” including the Retakāful providers.

Another thing is that there is a significant market for Takāful. The Islamic *Shari'ah* has contained basic ideas to produce more models and products in Takāful practice. The increasing acceptance of the Takāful concept and increased levels of business from compulsory lines and corporate business, which, in our view, should help provide a regular and stable stream of business.

At the global level, however, the Takāful system has not met with such a major degree of success as has been witnessed in the case of Islamic banking. This is for two reasons:

1. The huge investment required to compete with the conventional insurance industry.
2. The changes required in regulatory requirements, as seen in the case of Malaysia, to allow Takāful to compete on equal terms with the conventional industry.²⁷⁹

Takāful has a huge potential as there is increasing demand for a *Shari'ah* compliant system, particularly with the development of the Islamic banking industry. There has been low insurance density (premiums per capita) and low penetration (premiums as a percentage of GDP) in Islamic countries, mainly because of the belief of the majority of Muslims that insurance is un-Islamic, and that there is no alternative available to that system. With the development of Islamic banking, there has been a significant increase in the *Ijārah* and home mortgages which necessitate Takāful. Also, there is a need for Takāful in cases of personal policies, like motor vehicles, health and family security. The potential may be realised only if people are convinced through education and awareness about the features of the Takāful system, particularly about life

²⁷⁹ Ayub, M. (2007). Understanding Islamic Finance, P.428

Takāful. So far, only a small number of companies are providing comprehensive family Takāful policies.²⁸⁰

Finally, although the challenges persist in the Takāful sector, we believe that the potential for sustained growth and development would be achieved.

3.3.2 Policies/Products

Takāful operators offer both general Takāful and family Takāful products as the way the conventional insurance companies offer. General Takāful (Non-life) for alternative to general insurance while family Takāful (life) is the alternative to life insurance.

3.3.2.1 General Takāful

General Takāful or sometimes called Property & Casualty Takāful is a type of Takāful business which provides cover against financial loss to properties and other casualties / liability classes due to fortuitous circumstances and does not include another type of Takāful business namely Family Takāful which is essentially related to life of individuals including health.²⁸¹

IFSB²⁸² in its standards defines General Takāful as:

Schemes are basically contracts of joint guarantee on a short-term basis (normally one year), providing mutual compensation in the event of a specified type of loss. The schemes are designed to meet the needs for

²⁸⁰ Ayub, M. (2007). Understanding Islamic Finance, P.428

²⁸¹ Zulkifli, A.M., Abd Rahman, B.H., Yassin, N. and Ramly, J (2012). Basic Takāful Practices Entry Level for Practitioners, Kuala Lumpur: IBFIM, p. 219

²⁸² IFSB (2009). Guiding Principles on Governance for Takāful (Islamic Insurance) Undertakings, p. 6

protection of individuals and corporate bodies in relation to material loss or damage resulting from a catastrophe or disaster inflicted upon real estate, assets or belongings of participants. The Takāful contribution paid is pooled into the Participants' Risk Fund under the principle of Tabarru' to match the risk elements of the business that are inherent in its underwriting activities.

Property covered by Takāful should be recognised by law and *Sharī'ah*. Property defined as '*māl*' in Arabic and encompasses assets with intrinsic value that can be acquired, possessed and owned by a person or a body corporate and more importantly, recognised by law as well as *Sharī'ah*. In this respect, assets such as wine, swine, carrion, and stolen properties, birds in the sky and fish in the water are '*mal*' that are not recognised by *Sharī'ah*. Therefore, they cannot be covered by Takāful. Similarly, the sun, the moon and the stars are not considered assets that can be owned privately in accordance with the tenets of *Sharī'ah*. Furthermore, no value can be attached to them. Therefore, they cannot be covered by Takāful.²⁸³ In the same manner, property used for activities prohibited by *Sharī'ah* such as beer making factory, night clubs and pubs, gambling premises cannot also be covered by Takāful.²⁸⁴

There are numerous General Takāful products available under different names for the needs of both individuals as well as bodies corporate. Some are basic products while many are hybrid types. However, they may be generally classified into the following broad classes.

²⁸³ Yusof, M.F., Ismail, W.Z.W. and Naaim, A.K.M. (2011). Fundamentals of Takāful, p. 106

²⁸⁴ Zulkifli, A.M., Abd Rahman, B.H., Yassin, N. and Ramly, J (2012). Basic Takāful Practices Entry Level for Practitioners, p. 220

Table: 3.2: Products and Features of General Takāful

Main/Basic Products	Sub Products
Motor Vehicle Takāful	Motor Vehicle
	Motorcycle
	Commercial Vehicle
Fire Takāful	Standard Fire
	Industrial All Risk
	House Owner & Householder
Marine Takāful	Marine Cargo
	Marine Hull
Engineering Takāful	Machinery Breakdown
	Construction All Risk
	Erection All Risk
Miscellaneous Accident Takāful	Fidelity Guarantee
	Burglary
	Workmen's Compensation
	Personal Accident
	Money
	Public Liability

Source: Fundamentals of Takāful²⁸⁵

In addition to those products, the following General Takāful products also in practice in Takāful industry. travel Takāful, house coverage Takāful, plate glass Takāful, house content coverage Takāful, employees' liability Takāful, professional indemnity Takāful, material damage Takāful, leasing of plant and machinery Takāful, credit protection Takāful, group coverage Takāful, bonds Takāful, aviation Takāful and business Takāful.

3.3.2.2 Family Takāful

Family Takāful provides cover in the form of financial assistance upon the occurrence of events contingent upon human life that may result in financial hardship.

²⁸⁵ Yusof, M.F., Ismail, W.Z.W. and Naaim, A.K.M. (2011). Fundamentals of Takāful, pp. 105-121

Death will result in financial hardship to the dependents while prolonged old age also has its financial consequences. Both circumstances need to be planned and taken care of in terms of its financial impact. Apart from death and prolonged old age, there are other contingencies such as disability and sickness that may befall on the human life resulting in financial hardship in the form of additional medical expenses as well as loss of income and earning capacity.²⁸⁶

Family Takāful provides the participant with both a protection and long-term savings. A participant of a Family Takāful will contribute a certain amount of money to a Takāful fund. A part of the contribution will be apportioned to a fund called Participants' Special Account (PSA) or Participants' Risk Account (PRA) under *tabarru'* and the other part will be for savings and investment fund called Participants' Account (PA) or Participants' Investment Account (PIA).²⁸⁷ The portion that apportioned to the PSA will be used to fulfil the obligation of mutual help, should any of the participants face misfortune arising from the death or permanent disability. The Takāful operator will invest the participants' saving in the PA and the profit will be shared between the participant and the Takāful operator according to a pre-agreed ratio. If the participant suffers a tragedy, the beneficiary will be compensated with financial benefits from the PSA. However, if the participant survives until the date of maturity of the plan, he will be entitled to share the net surplus from the fund, if any.²⁸⁸

According to Maysami and Kwon,²⁸⁹ Takāful life insurance is named family Takāful or social Takāful. In this type of Takāful insurance policy that has a defined

²⁸⁶ Yusof, M.F., Ismail, W.Z.W. and Naaim, A.K.M. (2011). *Fundamentals of Takāful*, p. 415

²⁸⁷ *Ibid*, pp. 415 and 416

²⁸⁸ Zulkifli, A.M., Abd Rahman, B.H., Yassin, N. and Ramly, J (2012). *Basic Takāful Practices Entry Level for Practitioners*, p. 359

²⁸⁹ Maysami, R.M. and Kwon, W.J., *An Analysis of Islamic Takāful Insurance – A Cooperative Insurance Mechanism*, p. 8

period of maturity, insureds commonly make periodic level premium contributions that will be used primarily for meeting their individual savings target and in part for assisting financially the bereaved family of the deceased insured. The premium amounts vary from insured to insured depending primarily on the sum (face amount) that each insured targets to accumulate at the end of the coverage period and on the age, gender and health condition of that insured. The insurer may set the minimum face amount for this purpose. It may also set the minimum and maximum age limits for participating in this type of policy, accept standard risks only and maintain separate classes of insureds of the same age but with different year of entry to the plan.

Takāful life insurance is also used for other purposes, including generating a fund for children's education, securing a fund in case of mortgagor's premature death, protecting business interest against key-employee's death, getting an opportunity to earn halāl profits from the investment of contributions accumulated in the Takāful fund and providing an avenue to assist other participants through the concept of *tabarru'*.²⁹⁰ Several Takāful policies now come with hospitalisation and disability benefit riders. In fact, there is virtually a counterpart Takāful life insurance policy for each major type of conventional life insurance policy, while difference lies in how premiums are allocated.

In the family Takāful, the participants generally pay the contributions for two main purposes. Firstly, as donations to the Takāful fund to provide mutual indemnity among the participants. Secondly, as savings and investments for him or his family's benefits. Because of that, the contributions by the participants in family Takāful are normally credited in to the family Takāful fund which is then split in to two accounts,

²⁹⁰ INCEIF (2012). Takāful – Realities and Challenges, p. 245

namely: Participants' special account (PSA), which is the donation or risk account. Participants' account (PA), which is the savings and investments account.²⁹¹

Ali and Odierno²⁹² explain that family Takāful in Malaysia can be divided into two main plans; individual plan and mortgage plan. Under the individual plan, the benefits are generally as follows: upon maturity of certificate, the participant shall receive the amount accumulated in the Participants' account with the proportionate surplus, if any, arising from the participants' special account.

The mortgage Takāful plan is similar to the individual Takāful plan except that the donation or *tabarru'* is 100%. The surrender benefits are also slightly different in that they are equivalent to the Takāful contribution for the unexpired period of his/her participation which is calculated based on the participants' age at the time of surrender of the certificate and the amount of the reducing sum covered corresponding to that unexpired period of participation shown in the table of reducing sum covered under the Takāful plan.²⁹³

Muslim customers derive spiritual benefits by leaving specific instructions on how the monetary proceeds from the Takāful cover should be used in the event of his or her 'untimely' death. The following are examples:

1. To help settle his or her debts, which can be of enormous value to the deceased, because Muslims believe that people who die with debts cannot go to paradise, no matter how pious or faithful they have been, until all debts are settled.

²⁹¹ Ali, E.R.A. and Odierno, H.S.P. (2008). *Essential Guide to Takāful (Islamic Insurance)*, pp. 67 and 68

²⁹² *Ibid*, p. 68

²⁹³ *Ibid*, p. 70

2. To pay outstanding *Zakāh* (tithes), which are obligatory for Muslims with a certain level of wealth.
3. To pay someone else to perform the *Hajj* on behalf of the deceased. Performing the hajj is another obligation on Muslims who are able both physically as well as financially.
4. To purchase property such as mosques, hospitals or schools for the purpose of *Waqf* (benevolence) or to do other good deeds such as helping orphans, feeding the poor and the like. Although not obligatory, these acts are highly commendable from the perspective not only for Muslims, but all non-Muslims as well.

The above examples demonstrate that with unconventional creativity, Takāful products can be designed to provide additional utility (value) to faithful Muslims. This is because of the belief that the deceased can derive benefits in the form of rewards in the hereafter.²⁹⁴

Yassin and Ramly²⁹⁵ brief types of cover in Family Takāful as below:

- Individual Family Takāful (Individuals) – the plans include education, investment linked annuity mortgage, health and riders. You will receive financial benefits arising from death or permanent disability, as well as long term savings (investments), and investment profits that are distributed upon claim, maturity or early surrender. For instance: Savings Takāful, education Takāful, annuity/lifestyle Takāful, investment linked Takāful.
- Group Family Takāful (employees, clubs, associations and societies) – the plan include group education, group medical, retirement mortgage and riders. A minimum

²⁹⁴ Tarmidzi, A.N.M. (2007). Strengths and Opportunities of Takāful: the Spiritual Dimension, In: Sohail Jaffer, ed. (2007). *Islamic Insurance: Trends, Opportunities and the Future of Takāful*, pp.158 and 159

²⁹⁵ Yassin and Ramly (2011). *Takāful: A study Guide*, pp. 320 and 321

number of participants are required to qualify as a 'group' under these plans. You will receive protection in the form of financial benefits arising from death or permanent disability. Examples for this kind of Takāful are: Mortgage reducing term Takāful, group credit/cash line Takāful, employee benefit Takāful, group term Takāful, group immediate death Takāful, group hospitalisation & surgical Takāful, non-employee benefits Takāful, comprehensive group Takāful scheme.

- A family Takāful rider is an extension of the basic family Takāful. The rider provides coverage against personal accident and disability, medical and health. For instance: Critical illness Takāful rider, accidental death and disability Takāful rider, waiver of contribution Takāful rider, payer savings Takāful rider, term Takāful rider, hospital and benefit Takāful rider, family income Takāful rider.

With those products, Bhatt²⁹⁶ adds retirement plans, retirement annuities, *Waqf* plans – regular savings to accumulate funds established for special purposes (for example to help the needy).

²⁹⁶ Bhatt, A. (2007). The growth and global market for Takāful, In: Sohail Jaffer, Ed. (2007). Islamic Insurance: Trends, Opportunities and the Future of Takāful, p.15

Table 3.3 summarises the family Takāful products which are available in the market.

Table 3.3: Family Takāful Products

Main Product	Description
Ordinary Family	Individual Family Takāful (Individuals): The plans include education, mortgage, health and riders, travel, family plan and <i>Waqf</i> (endowment). The participant will receive financial benefits arising from death or permanent disability, as well as long term savings (investment), and investment profits that are distributed upon claim, maturity or early surrender.
	Group Family Takāful (employees, clubs, associations and societies): The plans include group education, group medical, health and riders. They require a minimum number of participants. Participants will receive protection in the form of financial benefits arising from death or permanent disability.
Annuity	This plan provides regular income to the participants upon retirement, based on the terms and conditions stipulated in the annuity policy or contract. This is possible only if the participants pay a lump sum to the Takāful operator or on an instalment basis until the total sum payable has been settled.
Investment linked	A portion of the participant’s contribution is invested in, for instance, equity or fixed income securities. The participant will benefit both from the investment profits as well as the Takāful protection that covers death and permanent disability.

Source: Takāful Realities and Challenges²⁹⁷

3.3.3 Models

There are two main systems in the Takāful operational model. One is the purely non-commercial Takāful system. In this cooperative system all participants agreed to manage their Takāful fund themselves. There is no external interference or management in this arrangement. They are guaranteeing each other with the Takāful fund, sometime, they may engage in commercial activities within themselves. This method is similar to the traditional mutual companies. Generally, regulatory and legal issues and complexities

²⁹⁷ INCEIF (2012). Takāful – Realities and Challenges, pp. 61 and 62

are lower than the operations with commercial aspects. Nevertheless, this method can be operated in a community, where the participants are capable, conscious, and knowledgeable about operational parts of insurance. And also there should be funds available to start the venture. Moreover, government support is needed for the continuity of the business. This system is mostly practiced in Sudan.

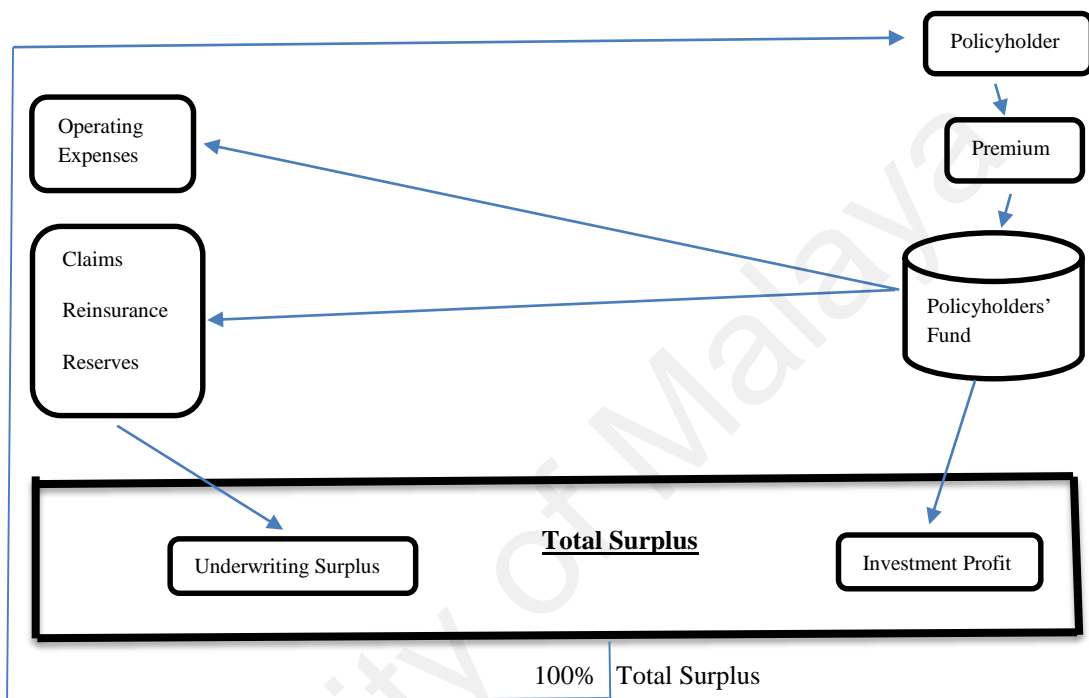


Figure 3.2: Cooperative/Mutual Takāful Model
Source: Takāful & Retakāful²⁹⁸

According to Ali,²⁹⁹

Many Muslim scholars suggest that purely cooperative or mutual form of insurance can be the basis of Islamic Insurance. In cooperative model, the management and control are in the hands of the members, who are also the policy holders. The insured and the insurers are the same people. The only purpose of such a model is mutual protection and security. There is no element of profit. Surplus, if any, needs to be ploughed back into the insurance fund. Contributions of the participants may also be increased or decreased as per experience of the operation of the scheme. Cooperative and mutual model of insurance can be operated in a society, where the participants are conscious and capable of running the technical aspects of insurance operation. Moreover, funds should be available to start the venture. Therefore, the commercial model is being practiced.

²⁹⁸ Frenz and Soualhi (2010). Takāful & Retakāful, p. 137

²⁹⁹ Ali, K.M.M. (2006). Basis and models of Takāful: The need for *Ijtihād*, Takāful Articles No: 03, ICMIF Takāful, p. 3

The other one is the commercial Takāful system. In this system, different models have evolved and practiced. Whatever the mode of operation, there will be some basic elements such as cooperation and mutuality, accountability, transparency, and lawful in *Shari'ah*. These operational models are described below.

3.3.3.1 *Muḍārabah* Model

In Islamic transactional law, *Muḍārabah* means: one person gives an amount of money to another person who will engage in trading with the given capital for the purpose to share the profits gained according to a pre-agreed ratio or percentage. Currently, this system is widely used by Islamic banks. The Takāful operators utilise this system for their investment venture.

Ali and Odierno³⁰⁰ explain the *Muḍārabah* model in the context of Takāful operation, it money had been contributed by the participants for their mutual benefit and protection. In this sense, the Takāful fund can be construed as belonging to the Takāful participants collectively. Once the money had been contributed by the participants into the Takāful fund on the basis of *tabarru'*, the participants than appoint the Takāful operator to be their manager by way of *Muḍārabah* contract to invest any available funds before and after payments of claims and other expenses (as and when they occur). The investment of the Takāful fund in this manner is to allow the fund to grow, rather than leaving it idle while waiting for claims or other expenses.

More specifically, when the participants enter into the *Muḍārabah* contract with Takāful operator, the participants collectively become the capital provider (*Rab al-māl*).

³⁰⁰ Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp. 33 and 34

The capital is the Takāful fund, which had been contributed by the participants by way of *tabarru'*. The Takāful operator becomes the manager (*Muḍārib*) to invest the fund in a *Sharī'ah* compliant manner and in accordance with the terms of the *Muḍārabah* contract. If there is any profit made, it is to be shared between the participants and the Takāful operator based on the pre-agreed ratio or percentage. Any losses are solely borne by the participants as capital providers (except in cases of negligence or fraud of the manager).

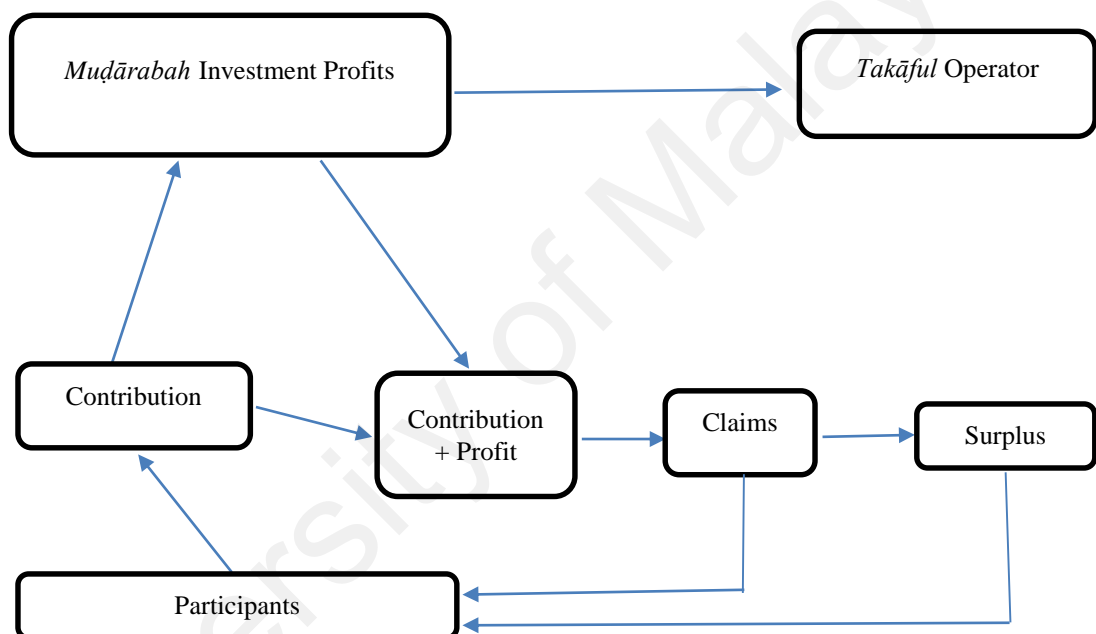


Figure 3.3: *Muḍārabah* Model

Source: Takāful (Islamic Insurance)³⁰¹

³⁰¹ Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 45

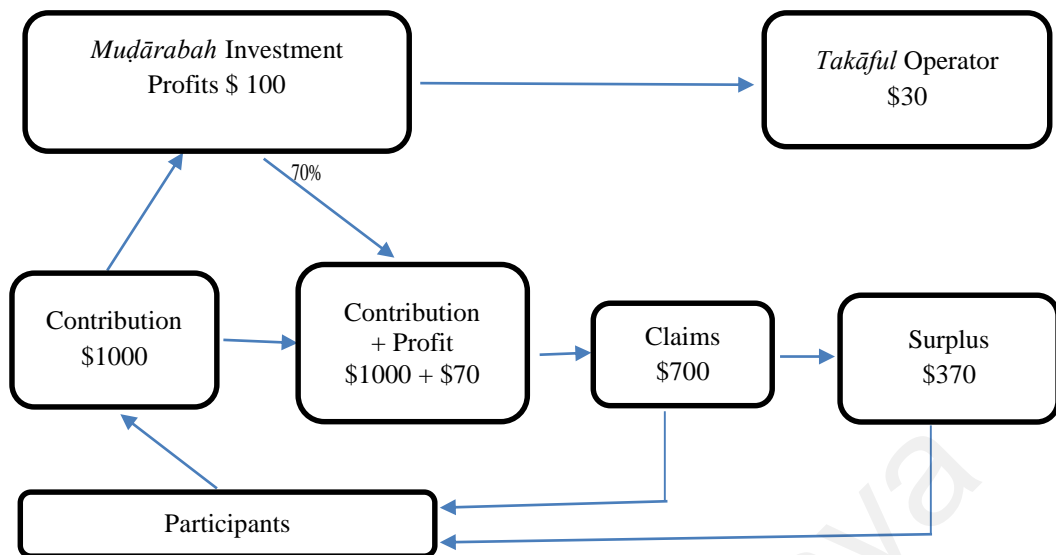


Figure 3.4: Simple Simulation for *Muḍārabah* Model

Source: Takāful (Islamic Insurance)³⁰²

Further,³⁰³ this is one of the earliest models of Takāful operation, especially in Malaysia, during the initial phase of the introduction of Takāful business in the country. The *Muḍārabah* model is also known as the “profit sharing model”. Two versions were developed. One included only investment profit sharing (sometimes called “pure” *Muḍārabah*), and another included the sharing of underwriting surplus (Sometimes called “modified” *Muḍārabah*). According to Zainal Abidin,³⁰⁴ the *Muḍārabah* for Takāful is rapidly losing ground as the Takāful model of choice. In Malaysia, of the nine Takāful operators at the time of writing this thesis (2007), only two practice the *Muḍārabah* model. These were also the first two Takāful operators to be established in Malaysia.

³⁰² Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 45

³⁰³ *Ibid*, pp. 43 and 44

³⁰⁴ Abidin, M.K.Z. (2007). Takāful: a question of surplus, In: Sohail Jaffer, ed. (2007). Islamic Insurance: Trends, Opportunities and the Future of Takāful, p.48

According to Ali,³⁰⁵ at present, there are three different *Muḍārabah* mechanisms. Some of the companies follow a pure *Muḍārabah* system, where the participants and the operator share direct investment income. Underwriting surplus, if any, is distributed entirely to the participants only. Some companies follow a practice of sharing surplus of the fund and profit from investment is ploughed back to the fund. A third practice is to share both the surplus and the investment income between the operator and the participants.

With regard to the eligibility of participants in the share of the surplus, there are two different approaches. Some are of the opinion that participants will be eligible to participate in the distributable surplus, provided they have not made any claims or received any Takāful benefits from the operator, or if they have surrendered/terminated policies. Others feel that the participants are eligible to the share of surplus if the claim is less than the contribution.

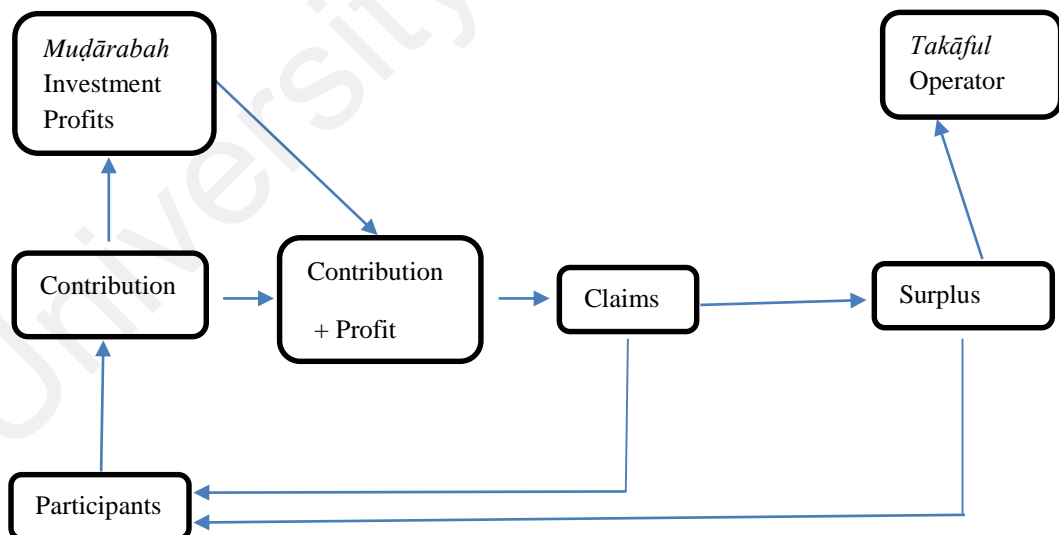


Figure 3.5: Modified *Muḍārabah* Model
Source: Takāful (Islamic Insurance)³⁰⁶

³⁰⁵ Ali, K.M.M. (2006). Basis and models of Takāful: The need for Ijtihād, p. 3

³⁰⁶ Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 46

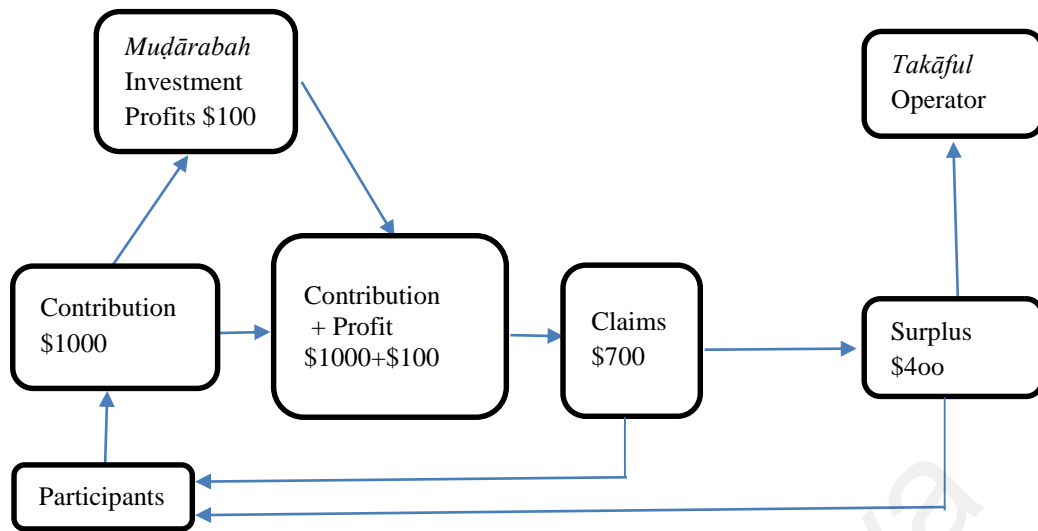


Figure 3.6: Simple Simulation for Modified *Muḍārabah* Model

Source: Takāful (Islamic Insurance)³⁰⁷

There are some *Sharī'ah* issues raised by some Muslim scholars regarding the operation of the *Muḍārabah* system in Takāful. Notably, Yacoubi and Abu Ghuddah as well as AAOIFI have brought into question the use of a *Mudārabah* contract in certain Takāful operations. The two main objections for its use have been the intermingling of the participant's contribution from a *Tabarru'* and *Muḍārabah* capital and the fact that a Takāful or insurance operation creates surplus not profits and therefore the use of a profit sharing contract may not be appropriate.

Others put forward Islamic legal questions about this operation. For instance, Abdul Rahim, Lewis and Hassan³⁰⁸ asked valuable question in this connection.

³⁰⁷ Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 47

³⁰⁸ Abdul Rahim, A. W., Lewis, M.K. and Hassan, M.K. (2007). Islamic Takāful: Business Models, *Sharī'ah* Concerns, and Proposed Solutions, pp. 371–396

The basic objective is to pay for a defined loss from a defined fund, which is set up mutually by policyholders but is managed by a Takāful company. The contributions given are based on the principle of *tabarru'*. A *tabarru'* is a one-way transaction in which once the contribution is paid, the contributor has no right to take any benefits out of it. Rather, the fund is used for any participant who faces financial difficulties or losses within the time period as agreed upon in the insurance policy. A number of issues arise.

First, there is a question whether all Takāful operators comply with the recommendation to accept *ta'āwun* (تعاون) as a basis for Islamic insurance. When people contribute their money, they are usually expecting something in return (i.e., financial reward or profit sharing). There is consequently a question mark regarding the true nature of *ta'āwun*. Is it really cooperative in nature? There are some operators using the cooperative insurance model, such as ICMIF London and NTUC Income Singapore, but they are rarities. While most insurers/ Takāful operators are described as the custodians or treasurers of the common fund, most of them are more than treasurers and, notwithstanding the words used, believe that they are actually the owners of the fund. Moreover, few of those who buy Islamic insurance are conscious that the premium is for mutual help.

Second, the relationship between the participants is one of *tabarru'* (donation) as defined in the contract and not of *Muḍārabah* (profit sharing contract). It is therefore of concern to *Sharī'ah* scholars that a profit sharing contract should not be applied here, as a donation cannot be *mudārabah* capital at the same time.

Third, in a *Muḍārabah* contract, a profit is generated to be distributed (although there are the usual concerns as to cash or accrual basis for accounting). Essentially, an

investment on a *Muḍārabah* basis of 100 should at the end of the period give more than 100 to be termed as profit and for the operator to share in that. However, profit is not the same as surplus (excess of premiums over claims, reserves, and expenses), and in the insurance context, no profit can be generated by definition so the question of distribution of profit is of concern.

Fourth, the sharing of the underwriting surplus makes the contract essentially the same as conventional insurance contracts, where the shareholders become risk takers and therefore bear the risk and return from the underwriting results just as any ordinary business venture and not a contract for mutual assistance with a fee charged by the operators as risk managers. Muhammad Ayub³⁰⁹ says that sharing in any underwriting surplus (UWS) makes the Takāful contract essentially the same as conventional insurance, in which the shareholders become the risk takers – they get the UWS or bear the underwriting loss (UWL); *Muḍārabah* -based Takāful is rather worse, because the Takāful operators/shareholders take only the UWS, but do not bear the UWL, if any. The point is that a Takāful operator should not be a risk-taker, which he becomes in the case of the *Muḍārabah* model.

Fifth, the requirement to provide a top-up interest free *qarḍ ḥasan* (قرض حسن) in case of a deficit) in a *mudārabah* contract by definition is against the concept of *Muḍārabah* (even if this really is a *Muḍārabah*), which is a profit sharing contract, and the *mudārib* cannot be a guarantor.

Sixth, because of a recognition that the application of the *Muḍārabah* approach to risk sharing does not seem to be correct, most new operators are applying the *wakāla-*

³⁰⁹ Ayub, M., (2007). Understanding Islamic Finance, P.426

based model as far as risk sharing is concerned (especially in the case of general Takāful and group family Takāful-type contracts where the investment element is not a part of the contract.

Under a pure *Muḍārabah* model, practiced mainly in the Asia-Pacific region, the participants and the operator enter into a *Muḍārabah* contract for cooperative sharing of losses of the members and sharing the profits, if any. The profit, which is taken to mean return on investments plus any underwriting surplus (as in the case of conventional insurance), is distributed according to the mutually agreed ratio, such as 50:50, 60:40, etc. between the participants and the company. The *Sharī'ah* committee of the Takāful company approves the sharing ratio for each year in advance. Most of the expenses are charged to the shareholders. An issue in this model is that the amount donated as *tabarru'* cannot simultaneously become capital for the *Muḍārabah* relationship. Moreover, the Takāful operator gets the underwriting surplus (UWS), but does not bear the underwriting loss (UWL). Therefore, *Sharī'ah* scholars have raised serious objections to this model.³¹⁰

However, the view of scholars and Islamic jurists, in particular those who have been serving on the *Sharī'ah* bodies of various Takāful operators in Malaysia, support the permissibility of the above model is based on the legal maxim where a ruling is decided based on the understanding of the issue. In this regard, one of the approaches used is the principle of '*urf* (عرف) as one of the secondary sources of *Sharī'ah*. In *Sharī'ah* Resolutions in Islamic Finance published by Bank Negara Malaysia, '*urf* is defined: "...as established norms and common to the majority of people in a community either in the form of sayings or doings". It is a common customary practice which is accepted and applicable as a legal basis of ruling as long it does not contradict the *Sharī'ah* ruling. In

³¹⁰ Ayub, M. (2007). Understanding Islamic Finance, P.424

the context of Islamic banking and finance, ‘urf *iqtisādi* (عرف اقتصادي) – a common business practice is considered as a basis of *Sharī’ah* rulings...”

Guided by the above, the model recognises contributions paid by participants as *ra’sul māl* (رأس المال) and only in the event of a loss incurred on the donation contract on the basis of *tabarru’* (تبرع). It is the ‘urf for general Takāful that the actual *tabarru’* cannot be determined at the inception of the contract until a loss occurs. Similarly, it is also the ‘urf, which the profit of the general business includes underwriting surplus which in the conventional operation it belongs to the shareholders. As the surplus forms part of the profit, under the Takāful structure it will be subjected to profit sharing to enable the operator to pay for its management expenses and should there be any balance thereof to be declared as dividends to its shareholders. The transaction as a whole does not breach the doctrines of ‘*adl* and *ihsān* (العدل والإحسان).³¹¹

3.3.3.2 *Wakālah* Model

Wakālah (وكالة) means agency. One person acts as agent (*Wakīl*) (وكيل) for another person in transaction, agreement etc. This action has been widely accepted by the *Sharī’ah* scholars because it is within the limitations of *Al-Qur’an* and *Al-Sunnah*.

Ali, and Odierno³¹² explain how the *wakālah* concept has been adapted to Takāful practice,

In a *wakālah* operational model, the Takāful participants principally contribute to the Takāful fund, as donation or *tabarru’*. Then, the participants as a group appoints and authorises the Takāful operator to be

³¹¹ Yusof, M. F., Ismail, W.Z. W., and Naaim, A.K. M. (2011). Fundamentals of Takāful, pp. 38 and 39

³¹² Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp. 49-52

their agent (*wakīl*) to manage the Takāful fund. The agency (*wakālah*) normally authorises the Takāful operator to be participants' agent (*wakīl*) to manage the Takāful fund, for both "insurance" as well as investment activities. The Takāful operator charges a *wakālah* fee for their management job.

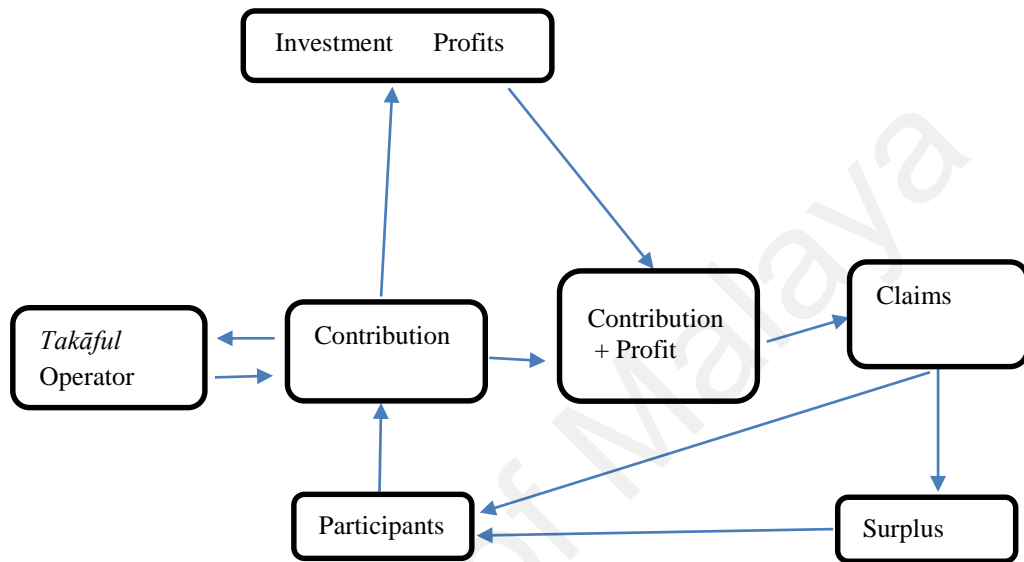


Figure 3.7: *Wakālah* Model

Source: Takāful (Islamic Insurance)³¹³

³¹³ Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 49

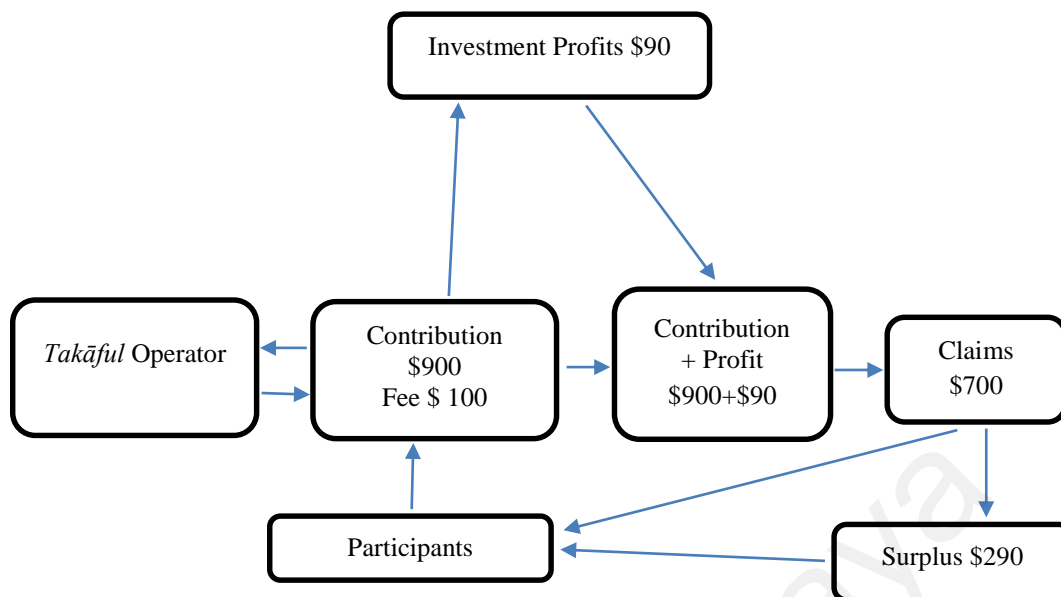


Figure 3.8: Simple Simulation for *Wakālah* Model

Source: Takāful (Islamic Insurance)³¹⁴

It should be noted that even in a *wakālah* model, the issue on how to treat the net underwriting surplus remains. Generally, the net underwriting surplus is treated as belonging to the Takāful fund because it originates directly from the fund; and the Takāful operator is just a manager and not owner of the fund. In view of this, the AAOIFI *Sharī'ah* standard No. 26 (5/5) of 2007 rules that the surplus can only be distributed back to the participants, and cannot be taken by the Takāful operator.

However, some Takāful operators feel that they should also get a “share” of the net underwriting surplus even when using a *wakālah* operational model. Thus, there have been instances where some Takāful operators take specified and agreed portions of the net underwriting surplus on the basis of “performance fee”. The underlying argument is, the good and expert management of the Takāful operator (especially in the underwriting

³¹⁴ Ali, E.R.A. and Odierno, H.S.P. (2008). *Essential Guide to Takāful (Islamic Insurance)*, p. 50
161

of contributions, assessment of risks and claim management) has contributed to the availability of the surplus and thus, they should be rewarded for the good performance. Although, they have been rewarded by way of a defined and agreed upfront management fee, they would like to enjoy additional income from the net underwriting surplus as incentives.

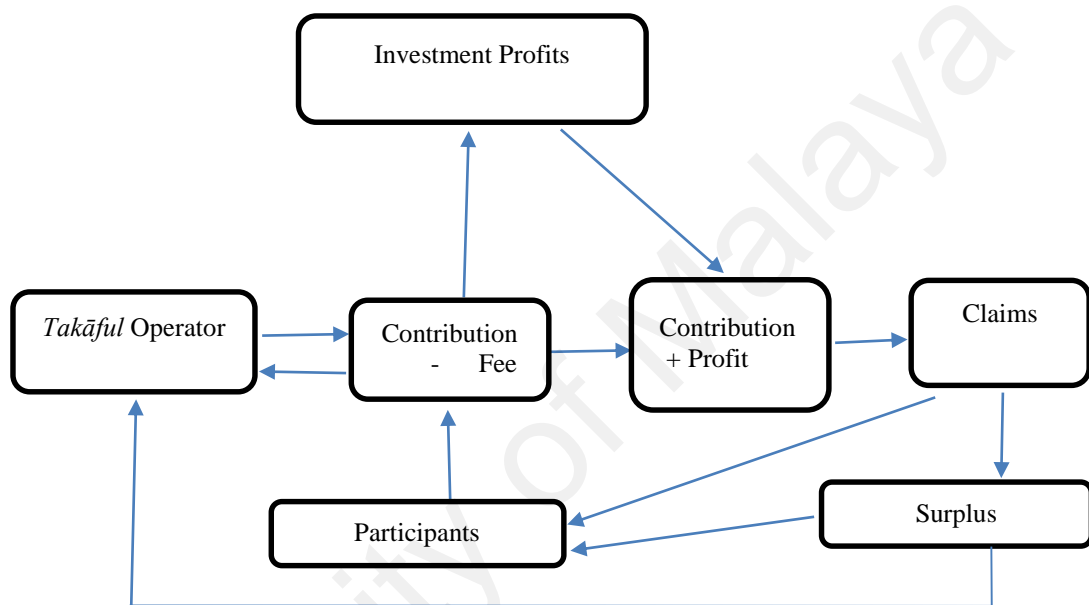


Figure 3.9: Modified *Wakālah* Model

Source: Takāful (Islamic Insurance)³¹⁵

³¹⁵ Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), p. 51

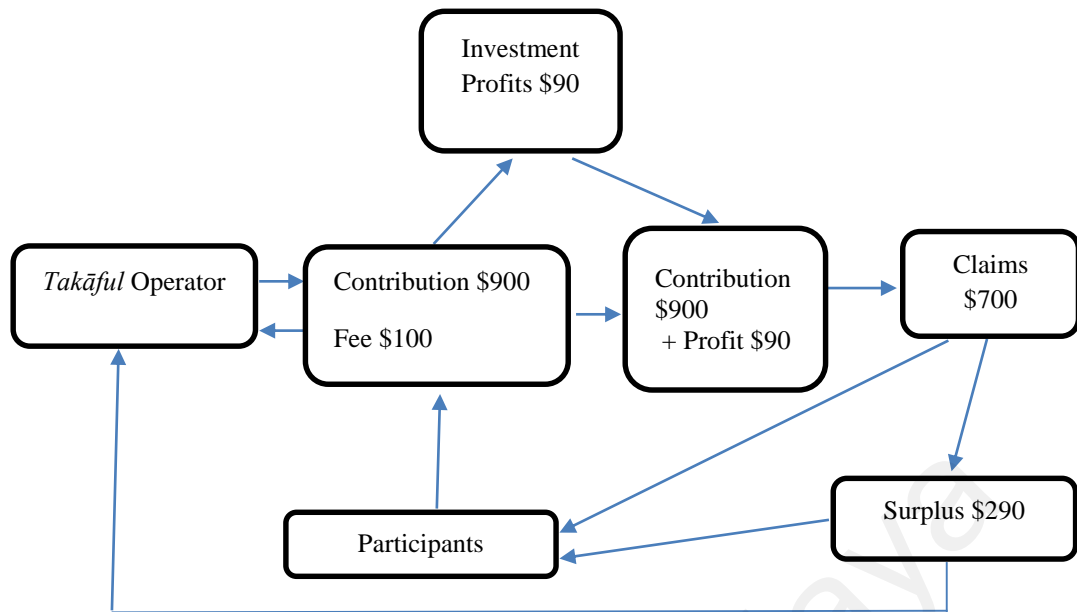


Figure 3.10: Simple Simulation for Modified *Wakālah* Model

Raj³¹⁶ and Ali³¹⁷ discuss the same ideologies and operational methods in their respective researches. Moreover, Ali³¹⁸ revealed that there are two different systems in operation in the Takāful companies which are mostly available in the Gulf countries. One is pure *Wakālah* system. Under this system, the operator gets a fixed amount of fee for the services rendered. Normally, the fee rate is fixed annually in advance in consultation with the *Sharī'ah* supervisory board. The other system is modified *Wakālah* system where a percentage share of the underwriting surplus is paid as a performance incentive for the operator.

In a pure *Wakālah* model generally practiced in the Middle East, the Takāful operator acts as a *Wakīl* for the participants and gets a fee in the form of an agreed percentage, say 30% of the participants' donations, and the whole UWS/UWL and the

³¹⁶ Shakun, A.R. (2007). Models in Takāful (MIR Takāful Models), p.87

³¹⁷ Ali, K.M.M. (2006). Basis and models of Takāful: The need for *Ijtihād*, p.3

³¹⁸ *Ibid*, p.4

investment profit/loss belongs to the policyholders or the participants. The *Wakālah* fee is to cover all management expenses of business. The fee rate is fixed annually in advance in consultation with the *Sharī'ah* committee of the company. In order to give incentive, a part of the UWS is also given to the operator, depending upon the level of performance. However, the loss (UWL), if any, has to be borne only by the participants. The operator simply provides *Qard al Ḥasan*. For this reason, the *Sharī'ah* scholars have expressed some reservation on this model, due to it not being equitable.³¹⁹

Wakālah combined with *Shirkah* arrangements (as in the case of most Takāful companies in the Middle East that give a part of any UWS to shareholders) is subject to the same objections as the *Muḍārabah* model. The problem arises when the Takāful operator is given a part of the UWS in addition to the operating fee as a performance incentive. Sharing of surplus should be among the pool members of the fund. And the risk premium should be separately defined and related to the risk; this should be the same for similar risks, regardless of who the client is.³²⁰

Abdul Rahim, Lewis and Kabir Hassan³²¹ say that although *Sharī'ah* scholars agree with the conceptual basis underlying the basic *wakālah* model, they have expressed some concerns, and some proposed solutions might better address these concerns.

First, under a typical *wakālah* model, the *tabarru'* (donation) remains the property of the participants unless consumed, as they have the right to receive the surplus back and therefore it becomes a conditional gift. This feature in turn gives rise to issues such as

³¹⁹ Ayub, M. (2007). Understanding Islamic Finance, P.424

³²⁰ *Ibid*, P.426

³²¹ Abdul Rahim, A. W., Lewis, M.K. and Kabir Hassan, M., 2007, Islamic Takāful: Business Models, *Sharī'ah* Concerns, and Proposed Solutions, pp. 371–396

inheritance (not possible to measure the share of surplus in the pool at time of death) and *Zakāh* in the case of the death of the persons, as the donation is a conditional gift. Also, the relationship is between the participants and the operator also among the participants (exchange of gift for a gift). As such, doubts are created about the contract becoming a contract of compensation.

Second, there are various generational matters. For example, contingency reserves may not be equitable between generations as the operator is likely to hold higher proportionate reserves in the early years for future contingencies. Since the participants keep changing on a continuous basis, it leads to an intergenerational equity issue. In a pure pooling arrangement, one should be able to call on members to actually contribute more in the case of a deficit on a pro-rata basis. This is not seen as practical in retail commercial insurance, and therefore alternative solutions may need to be explored for Takāful.

Third, another generational issue arises from the *qard ḥasan* for deficits. This is an obligation on shareholders that would be returned by future generations and is different from those that may have given rise to the deficit, as the participants keep changing on a continuous basis. Related to this, the wakīl should not be the guarantor of the participants he represents.

These three concerns are considered to be less serious than the two earlier ones. Solutions can be sought to these latter issues within the *wakālah* model as in principle this model is well accepted by most scholars from a Sharī'ah perspective.

3.3.3.3 Combined/ Hybrid Model

Combined or hybrid model is a mixed model of *Muḍārabah* and *Wakālah* models.

Swiss Re³²² writes,

The agent receives a pre-agreed share of the contributions paid by policyholders plus of the profits earned on investment activities. Some financial regulators and international organisations (e.g. the Accounting and Auditing Organisation for Islamic Financial Institutions, or AAOIFI) recommended the hybrid model because it leverages the strengths of both the *Wakālah* and *Muḍārabah* models. Applying the *Muḍārabah* model to investment activities helps mitigate principle-agent problems, whereas the use of the *Wakālah* model allows the operator to recover the administrative costs of underwriting.

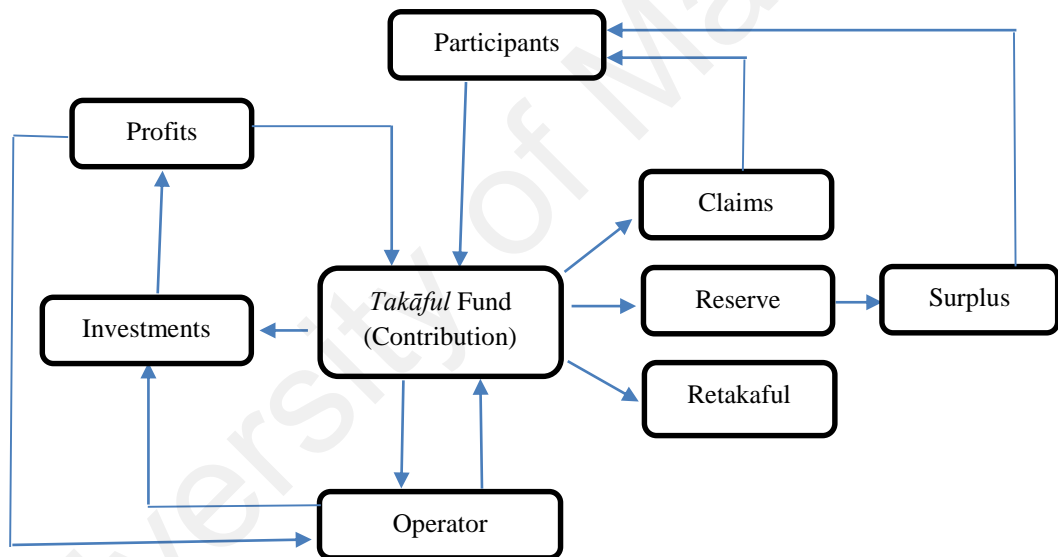


Figure 3.11: Combined Model

Source: Takāful (Islamic Insurance)³²³

According to Tolefat,³²⁴ the mixed model is the best approach for the Takāful business. He further elaborates that the mixed model of *al-wakālah / al-muḍārabah* is the

³²² Swiss Re (2011). *Islamic Insurance Revisited*, p.6

³²³ Ali, E.R.A. and Odierno, H.S.P. (2008). *Essential Guide to Takāful (Islamic Insurance)*, p. 53

³²⁴ Tolefat, A.R. (2006). *Mixed Model is best Approach*

dominant model in the Middle East market and it is widely practiced by Takāful companies worldwide. In fact, the central idea for all Islamic insurance models is the segregation between participants and shareholders' funds as the company role is only to manage participants' funds on their behalf. For this reason, any Takāful company is usually called a 'Takāful operator' instead of insurer.

The second principle for all Islamic models is that contributions (premiums) should be paid on donation (*tabarru'*) basis in order to remove the element of *gharar* from the Takāful contract. From the *Sharī'ah* point of view, and all Islamic models have to comply with these principles.

As for the structure of the mixed model, as has already been indicated, the Takāful company has two funds, one for the shareholders and the other for participants (policyholders). In the mixed model, *al-wakālah* contract is used for underwriting activities while *al-muḍārabah* contract is adopted for investment activities. With regard to underwriting activities, the shareholders act as the *wakīl* (agent) on behalf of participants to manage their funds whereby the Takāful company (shareholders) receive contributions, pay claims, arrange retakāful and all other necessary actions related to Takāful business. In exchange for performing these tasks, the company charges each participant a fee known as a *wakālah* fee, which is usually a percentage of the contribution paid by each participant.

This fee should be approved by the company's *Sharī'ah* Supervisory Board (SSB) and disclosed to participants in a very transparent manner. Although this fee is considered as the main source of income for the Takāful company, special attention should be given to determination of this fee. This is due to the fact that this fee is fixed and cannot be

changed after it is approved by the SSB and disclosed to participants. If the company fails to precisely calculate the level of the *wakālah* fee, then it may incur a loss and lose its main income source.

Furthermore, the Takāful company is also entitled to earn a fee if there is a surplus in the participants' fund as an incentive for the effort that has been done to manage the fund effectively. This fee is called the 'incentive fee' and usually it is determined as a percentage of the surplus in the participants' fund. As a matter of fact, scholars are in dispute regarding the legitimacy of such a fee as, many of them have stated, any surplus arising from the participants' fund is owned by the participants. Accordingly, this fee is only charged by a few Takāful companies, such as Bank Al-Jazeera in Saudi Arabia.

On the investment side, the company invests the surplus contributions in different Islamic instruments based on *al-muḍārabah* contract, whereby the company acts as *muḍārib* on behalf of participants '*rabb al-māl*' (capital provider). However, in order to satisfy the Sharī'ah requirement for *al-muḍārabah* contract, the ratio of profit is fixed and agreed upon between the two parties, at the inception of the contract.

As seen, the adoption of *al-Wakālah* contract in underwriting activities is more transparent and reduces elements of conflict of interest between the two parties. Moreover, the company has several sources of income under this model, which are *Wakālah* fee, incentive fee and its profit share from investment activities. It can thus be concluded that a unified approach by all Takāful companies is crucial to the development of the industry and to enhance confidence and understanding of consumers as well as conventional insurers. As Bahrain has taken the initiative towards a unified Takāful model, it is hoped that other countries will follow.

Under the combined model, the sharing of profit between participants and operators is an entitlement embedded in the contract, i.e. UWS and the investment profit both are shared. There is, however, a structural issue in the way such profit/surplus is determined. The issue is that, under *Muḍārabah*, the operator, as the *Muḍārib*, cannot charge its management expenses from the Takāful fund separate from its share as *Muḍārib*, whereas under *Wakālah*, the operator, being the agent of the participants, can take its management fees from the fund as per pre-agreed terms. Further, the operator does not bear the UWL. It also smacks of trouble from the perspective of the *Sharī'ah*.³²⁵

3.3.3.4 *Waqf* Model

Waqf (وقف) is a good deed encouraged by the *Sharī'ah*. Normally, it is used for charitable activities, through developing and maintaining of mosques, Islamic religious schools, cemeteries, orphanages etc. It has been practiced by Muslims throughout history to strengthen the religious rituals, education, safeguard historic places, and relieve hardships.

Waqf is the retention of a property that cannot be sold, and assignment of the usufruct for the benefit of a charitable or humanitarian objective, or for a specified group of people, such as the members of the donor's family. The profits and returns produced by the property subject to the *Waqf* belong to its beneficiaries and, if they are succeeded, it then goes to the closest relatives of the stipulant or, according to another *Hanbali* opinion, to the poor. *Waqf* is a contract, despite the fact that it is constituted by a unilateral

³²⁵ Ayub, M. (2007). Understanding Islamic Finance, p. 424

act does not need the consent of the beneficiaries, who in many cases are a category of people such as the poor or destitute.³²⁶

In practice as a model of Takāful, it works as Asmak and Ahmad³²⁷ explained,

Participants hand over funds to the Takāful company that will divide it between two accounts for investment. ‘Account 1’ is the participant’s account (Takāful participants’ designated savings) which will yield profits from investments made by the company. Once the policy ends, participants who are still alive will receive his/her savings from the savings account as well as profits from investments made by the Takāful company. Should the participant pass away, funds donated by this participant will be inherited in accordance with farāīḍ law. ‘Account 2’ contains *tabarru’* funds donated by all participants. These funds will also be invested and participants will receive profits from investments made by the Takāful company. This fund will be spent on the following: During the contract period, should a misfortune befall the participant, such as becoming permanently invalid, then the participant will receive monetary assistance from the *tabarru’* (*ṣadaqah*) fund. Should the participant pass away, his/her family will receive monetary assistance from the *tabarru’* fund”.

Taqi Usmani³²⁸ believes strongly in the *Waqf* model. He feels that *Waqf* is more compatible with the cooperative concept of Takāful as it is created for the very purpose of cooperation. He said that if one establishes a fund for Takāful, then the fund should have a legal entity. So whenever one contributes to this fund, the contribution is regarded as a contribution for the common good. When the *Waqf* fund distributes the funds between the members according to its own rules, the fund needs to have its own legal entity, and according Islamic jurisprudence, *Waqf* is an independent entity, hence he prefers this model.

³²⁶ Khorshid, A. (2004). *Islamic Insurance – A Modern Approach to Islamic Banking*, p. 20

³²⁷ Asmak, A.R., and Wan Ahmad, W.M. (2011). *The Concept of Waqf and its Application in an Islamic Insurance Product: The Malaysian Experience*, p.210

³²⁸ Raj, S.A. (2007). *Models in Takaful (MIR Takāful models)*, p. 88

According to Ali and Odierno,³²⁹ Farooq, Chaudhry, Fakhr-e-Alam and Ahmad³³⁰ and Ayub,³³¹ the *Waqf* model focuses on the *tabarru'* aspect of the Takāful arrangement. The management and operational aspect of the Takāful fund may still use the *wakālah* and *Muḍārabah* contracts.

Under the *Waqf* model, the Takāful operator initiates the *Waqf* fund by contributing a “ceding amount” of donation for the purpose of compensating the beneficiaries, i.e. the participants of Takāful scheme. This initial ceding amount will remain in the *Waqf* fund throughout the Takāful operation of the operator.

The Takāful operator then invites the Takāful participant/s to contribute to the *Waqf* fund, which principally operates as a Takāful fund. Any person who participates by signing the proposal form and subscribing to the policy documents shall become a member of the Takāful scheme as well as a Takāful beneficiary of the *Waqf* cum Takāful fund. The *Waqf* deed lays down the rules for distribution of its funds to the beneficiaries and decides on how much compensation to be given to a member / participant in the event of perils.

In essence, the *Waqf* fund will be used to extend benefits and protection to the Takāful participants in accordance with the *Waqf* deed/ terms. The *Waqf* is considered as a “legal entity” that can exercise ownership rights over the contribution amount subject to the terms of *Waqf* deed, particularly on investments, compensations and the status of surplus amounts.

³²⁹ Ali, E.R.A. and Odierno, H.S.P. (2008). Essential Guide to Takāful (Islamic Insurance), pp. 55-56

³³⁰ Farooq, S.U., Chaudhry, T.S., Fakhr-e-Alam and Ahmad, G. (2010). An Analytical Study of the Potential of Takāful Companies, p.59

³³¹ Ayub, M. (2007). Understanding Islamic Finance, pp. 424 and 425

The Takāful operator will be the manager of *Waqf* cum Takāful fund. The management by the operator can take two forms:

- *Wakālah* – to manage the “insurance activities” of the *Waqf*, such as underwriting contributions, actuarial assessment of risks and payment of claims; and
- *Muḍārabah* – to invest the fund in *Sharī’ah* compliant investments.

The operator gets a fee for the *wakālah* management, which is deducted from the contributions of the participants. In addition, the operator will also get a share of *muḍārabah* investment profits based on a pre-agreed profit sharing ratio.

Any surplus in the *Waqf* fund after payment of claims and other related expenses will be distributed as per the *Waqf* deed, which normally involves the following three alternatives.

1. The surplus or a portion of it may be kept as reserve to mitigate future losses.
2. The surplus or a portion of it may be distributed back to the participants as cash distribution or NCD (no claim discount) /NCB (no claim bonus).
3. The surplus or a portion of it may be utilised for charitable purpose.

In the event that the *Waqf* fund is liquidated, any outstanding balance after paying all dues and payables will be distributed to charity as per the terms of the *Waqf* deed.

According to the latest research by over 40 *Sharī’ah* scholars conducted under the guidance of Taqī Usmani, a renowned contemporary jurist and member of the *Sharī’ah* councils of the OIC/IDB and the AAOIFI, a *Waqf* model or a combination of *Wakālah* and *Waqf* is the best basis for evolving a practical Takāful system in line with the *Sharī’ah*

principles. Even prior to that, some jurists advocated the use of a *Waqf* mechanism to develop a *Sharī'ah* compliant insurance system.³³²

Some scholars consider this model the *Wakālah – Waqf* model. Ali³³³ explains that,

Some of the *Sharī'ah* scholars have critically analysed the *Wakālah* system and have suggested to incorporate the concept of *Waqf* into the *Wakālah* model. Under this revised model, the operator would initially make a donation to establish a benevolent fund called the *Waqf* Fund. When this *Waqf* is created, the shareholders will lose their ownership rights on the waqf. However, this fund will be administered by the operator. The donations received from participants, seeking Takāful protection, will also be deposited into this fund and the combined amount will be used for investment. Profits earned will be deposited into the same fund. Participants will be given benefit from this *Waqf* fund. The *Waqf* fund would be allowed to form contingency reserve fund apart from usual technical reserves. The *Waqf* fund rules would define the basis for compensation and financial help, and rules for sharing surplus between the members and operators.

Billah³³⁴ noted that each of these models has its own strong and weak points, and none can be distinctive from the other as each meets the needs of a particular market. It is difficult to judge the full extent of the merits of each of these models which all serve their purpose in their own way. None of them are perfect, and there must be concerted efforts to fine tune them to solve the problems in each of the models. This is the only way forward to ensure the success of Takāful throughout the world.

Takāful practitioners, *Sharī'ah* experts, and government authorities should cooperate to plan the strategic solutions. Educating them is the answer. There is a constant debate on the usage of the models, and this is always highlighted when Takāful practitioners come together at conferences. Many have expressed their opinions that the

³³² Ayub, M. (2007). Understanding Islamic Finance, pp.423 and 424

³³³ Ali, K.M. (2006). Basis and Models of Takāful: The need for Ijtihād, p. 3

³³⁴ Billah, M.M., Different Models of Takāful in the Global Sound Market, p.16 and Shakun A.R. (2007). MIR Takāful Models, p.88

Sharī'ah councils should come up with a standard model for international use. However, since different regions have their own laws, having a standard global model may be difficult to implement. Some do not accept certain models that do not agree with their laws. The jury is still out on when and how a standard global model will evolve.

3.3.4 Contracts

A contract or “*‘aqad*” in Arabic is an essential need in dealings between mankind. Its importance can be seen in every facet of human relationship and transaction in day-to-day life. In essence, a contract or an *‘aqad* binds the relationship of agreement between at least two individuals or parties in a variety of transactions and in particular that which is related to business and commerce.³³⁵

A *Sharī'ah* compliant exchange contract of business has three primary characteristics, namely:

‘Āqid (عاقِد) - Parties to the contract: The contacting parties are the entities who enter into a binding agreement. They are those who make the offer and acceptance. They must be able to establish their rights for and obligation upon themselves. This means that they must be of age or have attained puberty, are sane and mature and of sound mind.³³⁶

Ma'qūd 'Alayh (مَعْقُود عَلَيْهِ) – Subject matter of the contract: The subject matter must fulfil the following criteria for the contract to be valid:

³³⁵ Yusof, M.F., Ismail, W.Z.W., and Naa'im, A.K.M. (2011). Fundamentals of Takāful, p. 53

³³⁶ Alhabshi, S.O., Kamaruddin, S., Hamzah, A.R. and Ezamshah, I. (2012). Takāful Realities & Challenges, pp. 94 and 95

1. The subject matter must be legal and permissible and not forbidden by *Sharī'ah*. (the existence of *ribā* (usury), *gharar* (ambiguity) or *mysir* (gambling) will automatically render the contract void.)
2. The subject matter should be deemed valuable to both the contracting parties. Its value is determined by the commercial custom or '*urf*'.
3. The subject matter must be legally owned by the contracting party. If it is not yet owned, such as a fish in water or bird in air, the contract cannot be concluded.
4. The subject matter must be known to the parties, whether it be in terms of quantity, quality, etc.
5. The subject matter can be handed over to the party who is supposed to receive it at the conclusion of the contract.
6. The subject matter must be available at the time the contract is being concluded.

Only exceptions to this general rule are the subject matters under *salam*, *istiṣnā'* and *ijārah* contracts.³³⁷

Sīghah (صيغة) - The declaration or expression of offer and acceptance or *ījāb* and *qabūl*: the basis for the formation of a contract is mutual consent. However, consent is an intangible mental fact. Therefore, this intention must be manifested in a sufficiently formal agreement or conduct that indicates a definite intention to contract. *Sīghah* is a method to manifest the intention to contract. It consists of utterances to offer (*ījāb*) and to accept (*qabūl*) the intentions of the contracting parties. The contract is said to be concluded when the connection between the offer and acceptance takes place.³³⁸ In the practice of insurance putting the signature upon agreeing to the list of questionnaires,

³³⁷ Alhabshi, et al. (2012). *Takāful Realities & Challenges*, pp. 95 and 96

³³⁸ *Ibid*, p. 94

statements and declaration in the proposal and declaration form marks the *sīghah*. Under this pronouncement the ‘offer’ is referred to *tjāb* and the ‘acceptance’ is termed *qabūl*.³³⁹

Furthermore, *gharar* (غرر) is one of the major causes of the invalidity of a contract. It is an external prohibited attribute that invalidates the contracts. Literally, *gharar* means risk or hazard. *Taghrīr* (تغريير) being the verbal noun of *gharar* is to unknowingly expose oneself or one’s property to jeopardy. It includes such elements as doubt, suspicion, uncertain conditions, the absolute lack of knowledge about and in determinability of the basic elements of the subject matter.³⁴⁰ Accordingly, a large number of contemporary Muslim jurists regard modern commercial insurance invalid and incompatible with the injunctions of Islamic law. Islamic law does not allow *gharar* transactions in which the seller does not know what he has sold and the purchaser does not know what he has purchased. In insurance, the buyer of insurance policy does not know what he has bought by his premium. The time of occurrence of event is also uncertain for the parties. As such, insurance is primarily a *gharar* contract.³⁴¹

Insurance contract as practiced by conventional insurance is a contract of exchange ‘*Aqad al Mu’āwadah* (عقد المعاوضة) where the insured pays the premium to the insurer in exchange for the promise to indemnify by the insurer in the event of a loss. But, under the Takāful contract, the participants agree to relinquish a portion or the whole of the Takāful contribution as *tabarru*’ (تبرع) (to donate, to contribute, to give away) to the defined fund, thus enabling him to fulfil his obligation of mutual help and joint guarantee should any of his fellow participant suffers a defined loss.

³³⁹ Yusof, M.F., Ismail, W.Z.W., and Naa'im, A.K.,M. (2011). Fundamentals of Takāful, pp. 54 and 55

³⁴⁰ Mansuri, M.T. (2006). Islamic Law of Contracts and Business Transactions, p. 93

³⁴¹ *Ibid*, p. 103

The element of *tabarru'* makes it no longer a contract of exchange but instead a contract of cooperation and mutual help where uncertainty is no longer relevant. In line with the principle of cooperation, mutual help and joint responsibility the concept of Takāful would therefore entail each person participating in the programme to agree giving away as donation a certain portion or the whole amount of his contribution into the fund or the common pool. It is from the fund that financial assistance is paid in the event of a loss or damage inflicted by a defined catastrophe on any of the participants, taking undue advantage among and between participants does not arise. Thus there is no element of gambling or unjust enrichment under this arrangement.³⁴²

3.3.5 Takāful Windows

Takāful / re-Takāful 'Window' Operator – A registered insurance or reinsurance company authorised by the authority to carry on Takāful business as 'window' operations alongside the conventional insurance business³⁴³ but managed differently in accordance with the different underlying principles. Takāful windows often segregate the funds independently and are overseen by a *Sharī'ah* Advisory Board/Council that provide *Sharī'ah* inputs and ensure compliance.³⁴⁴

The participants in a Takāful fund are conceptually distinct from both conventional policyholders of the insurance company and its shareholders. However, the *Sharī'ah* requirement for the Takāful fund to be segregated from the assets of the Takāful operator (and therefore segregated from the liabilities of the conventional insurance policies) should, if properly structured, be effective to minimise any conflict of interests.

³⁴² Yusof, M.F., Ismail, W.Z.W., and Naaim, A.K.M. (2011). Fundamentals of Takāful, pp.17 and 18

³⁴³ Insurance Regulatory Authority of Nairobi (2015). Takāful Operational Guidelines, p. 5

³⁴⁴ Abbas, M. (2012). Takāful Regulation in a Conventional Set up, p. 1

There are two key benefits for the industry in allowing Islamic windows: One is attracting new players to the market: if it is necessary to establish a new legal entity solely for the purposes of undertaking Takāful business (with the associated costs of incorporation and capitalising such an entity), it is less likely that conventional insurers will be prepared to enter this market. The experience of entities such as Swiss Re, which established an Islamic window in Switzerland for the purposes of writing retakāful business in 2006, before subsequently establishing a branch company for this business in Malaysia in October 2009, demonstrates the attraction of Islamic windows. Anecdotal evidence suggests that Swiss Re would not have been prepared to undertake retakāful business if the Islamic window had not been an option. Second one is financial strength: The lower start-up costs for Islamic windows combined with the fact that the Takāful operator/conventional insurer can generate income through its conventional business coupled with the ability to achieve economies of scale in front and back offices is a significant advantage. It reduces the pressure on the Takāful operator to write business purely to generate a volume of income necessary to cover overheads etc.

The benefits of Islamic windows outweigh the potential issues (all of which are capable to resolution). It is to be hoped that the regulators take the necessary steps to encourage Islamic windows in a controlled environment through the introduction of carefully considered regulation of this important sector of the Islamic finance community.³⁴⁵

As Abdul Rahim³⁴⁶ indicates, a Takāful operator with a dedicated operation would hopefully be seen by the public as a better alternative than a conventional insurer having

³⁴⁵ Eisenberg, D., (2012). *Islamic Finance: Law and Practice*, p. 311

³⁴⁶ Abdul Rahim, A.W., *Takāful Business Models, Opportunities, Obstacles and Practical Recommendations for Islamisation of Insurance System in Pakistan*, p. 7

both products. International experience indicates less than 5% of Takāful business is from window operations. The rest is all from dedicated Takāful operations. Countries like Malaysia and in the Middle East have also not allowed conventional insurers to introduce Takāful products and require a separate Takāful company.

3.3.6 Retakāful

It is an arrangement or a mechanism either by an agreement that enables a direct Takāful operator, called the ‘cedant’, to transfer or cede a part of the risk that it has accepted, to another Takāful or retakāful operator. The primary objective of retakāful is to reduce the risk exposure and liability of the cedant in the event of a claim. This concept of sharing would enable a wider distribution of the risks and secure the Takāful operator the full advantages of the law of large numbers. Retakāful would contribute towards reducing the financial strain of the Takāful fund.³⁴⁷

In simple terms, if Takāful is the retail aspect of the business between the Takāful operator and the participants at large, retakāful may be aptly described as the wholesale aspect of the business between the Takāful operator and other Takāful and retakāful operators.³⁴⁸ Retakāful is ‘Takāful of Takāful’. The underlying principles of Takāful is sharing of risk and in order for Takāful to grow, there is a need for retakāful operators.³⁴⁹

The Takāful Act 1984 of Malaysia states that retakāful is an arrangement consistent with sound Takāful principles for retakāful of liabilities regarding risks

³⁴⁷ Zulkifli, A.M., Abd Rahman, B.H., Yassin, N. and Ramly, J (2012). Basic Takāful Practices Entry Level for Practitioners, p. 113

³⁴⁸ Yusof, M.F., Ismail, W.Z.W., and Naaim, A.K.M. (2011). Fundamentals of Takāful, p. 517

³⁴⁹ INCEIF (2012). Takāful – Realities and Challenges, p. 501

incurred or to be incurred by the Takāful operator in the course of his carrying on Takāful business.³⁵⁰

Retakāful is defined as a contract whereby one for a consideration agrees to indemnify another wholly or partially against loss or liability by a risk the latter has covered under a separate and distinct contract as operator of a third party.³⁵¹

In line with the scholars' resolution on the permissibility of Takāful as a system of Islamic insurance, retakāful likewise has been resolved to be *Shari'ah* compliant along with the same principles of Takāful.³⁵²

... Commercial insurance contract commonly used by commercial insurance companies is a contract which contains major elements of risks which is prohibited according to *Shari'ah*. The alternative for both insurance & reinsurance should be based on the principles of cooperative insurance...³⁵³

Retakāful allows operators to share risks that they cannot, or do not wish, to absorb themselves. It does not, in principle, differ from Takāful operations. The *Shari'ah* principles applying to Takāful apply to retakāful operations as well. The difference, if any, is that in retakāful operations, the participants are Takāful operators instead of individual participants. It is argued that the current practice of insurance business has shown that a Takāful ceding company cannot do without the retakāful facility. Therefore, there is a need for Takāful operators to split risks by way of establishing retakāful operators. By doing so, the Takāful operators share their risks with retakāful companies. The retakāful operator, on the other hand, assumes the responsibility of managing and

³⁵⁰ Bank Negara Malaysia, Act 312 (1984) Takaful Act 1984, p. 6

³⁵¹ Zulkifli, A.M., Abd Rahman, B.H., Yassin, N. and Ramly, J (2012). Basic Takaful Practices Entry Level for Practitioners, p. 113

³⁵² Yusof, M.F., Ismail, W.Z.W., and Naaim, A.K.M. (2011). Fundamentals of *Takaful*, p. 518

³⁵³ Fiqh Academy of Organisation of Islamic Cooperation, Resolution No. 9, December 1985

investing the premiums of Takāful operators on the basis of Profit Loss Sharing.³⁵⁴ The main purpose of retakāful is also similar to that of reinsurance – to spread risk and add capacity so that larger or more risks can be written. By spreading risk within the Takāful industry, retakāful enables the Takāful industry to function more efficiently.³⁵⁵

Reinsurance agreements take place between the Takāful operator and the retakāful operator. It is a company-to-company relationship and it is essentially about handling risk. The original policyholders are not party to the reinsurance agreement. Nevertheless, the insured may have an indirect interest in knowing that a professional and sound reinsurer is administering the original policy since this concerns its security. However, it has not and cannot have any direct interest in the reinsurance contract.³⁵⁶ Some legal scholars emphasised that the contract of retakāful should remain between the two operators, the Takāful and retakāful operators. The participants in the original Takāful fund are not party to the contract in any way.³⁵⁷ It is, however, recommended to have the consent of the original Takāful participant before entering into a retakāful contract.³⁵⁸ Thus, the operational and legal relationship of the retakāful and Takāful operators may be summarised in the following:

1. The retakāful operator mobilises premiums or contributions of Takāful companies, assumes responsibility to invest this fund on the basis of *muḍārabah* and shares the proceeds with Takāful operators;

³⁵⁴ Lashin, F. (1990), *Sīgha Muqaddamah li al-Sharikat Ta'mīn wa I'adat al-Ta'mīn fi al-Islam*, pp. 95-122

³⁵⁵ Frenz, T., and Soualhi, Y. (2010). *Takāful & Retakāful*, p. 263

³⁵⁶ Al-Garahdagī, "al-Dawābit al-Shar'iyyah li-'Uqūd al-Ta'mīn 'ala al-Hayāt", pp. 169-216

³⁵⁷ Al-Darīr, S. M. A., "al-Ta'mīn al-Tijāri wa I'adat al-Ta'mīn bi-al-Suwar al-Mashrū'ah wa al-Mamnū'ah", pp. 123-137

³⁵⁸ Yaquby, S. N., "The role of *Sharī'ah* Supervisory Board in Islamic Insurance," a paper presented at the International Conference on Takāful (Islamic Insurance), 2-3 June 1999, at the Hilton Hotel, Kuala Lumpur, Malaysia, p. 3,

2. In the event of profit, it will be distributed between the retakāful operator and Takāful operators according to the defined percentage contained in the agreement certificates issued;
3. In the event of perils, the retakāful operator indemnifies the defined risks and settles expenses of the process of Takāful from the gross premiums, reserves and proceeds of investment;
4. In the event of surplus, it should be proportionately credited into the Takāful operators' account;
5. The retakāful operator underwrites the insolvency of the Takāful operator by undertaking to provide a loan from the retakāful shareholders' fund by which the Takāful operator settles claims and the incoming premiums will be a source of recovery of the loan.³⁵⁹

The legality of reinsuring a conventional insurance company by a retakāful operator lies in the question of legality of insuring non-Islamic properties, products, and financial activities. Basically, it is illegal for Takāful operators to insure non-Islamic properties, products and activities. Therefore, by the same token it is forbidden for Takāful operators to reinsure conventional insurance companies. The reason is that the management and investment nature of these companies is geared in a manner contrary to *Sharī'ah* investment requirements. In addition, the Islamic investment principles were designed to serve various requirements of Islamic teachings. Among these is to mitigate or wipe out unlawful activities, not to protect and promote their existence. Thus, reinsuring conventional insurance companies indirectly means protecting and strengthening the existence of unlawful activities.³⁶⁰

³⁵⁹ Arbouna, M.B. (2000). The Operation of Retakāful (Islamic Reinsurance), pp. 342-343

³⁶⁰ Al-Ashqar, M. S., *Al-Ta'mīn 'ala al-Hayāt wa I'adat al-Ta'mīn*, pp. 143-169

Some scholars have argued that the present situation of Takāful practices shows that there exists no need for reinsurance cooperation with conventional reinsurers. It is thus argued that if there exists a necessity for such cooperation, invoking the law of necessity or dire need for this purpose is inappropriate. The law of necessity is invoked to legalise an unlawful act which, if not committed, could lead to death or something similar. This does not, however, exist in the present situation of Takāful companies. In other words, if Takāful operators did not streamline their reinsurance cooperation with conventional reinsurance companies, it would not lead to death for which the principle of *darūrah* can be invoked. The application of *hājah* (dire need) is invalid too because, as a legal principle, it cannot legalise an act explicitly declared by sources as unlawful (e.g., *ribā*) in any way. Moreover, the application of these principles is quashed by the emergence of a large number of Takāful companies worldwide. Thus, the collective coinsurance method among Takāful operators can make the need for retakāful or reinsurance protection possible. Hence, there remain no grounds for looking to the principles of necessity and need to legalise reinsurance cooperation with conventional reinsurance companies.³⁶¹ The need for the reinsurance facility itself is, they argued, a convincing proof to accelerate and facilitate the establishment of retakāful operations on the basis of cooperation.³⁶²

Based on the views of the experts in the insurance industry, some scholars opine that there is a necessity or dire need for Takāful operators to seek reinsurance protection from conventional reinsurers. The necessity or need lies in the fact that the financial capacity of existing Takāful operators is inadequate to meet all their losses. In this regard,

³⁶¹ Al-Ashqar, M. S., *Al-Ta'mīn 'ala al-Hayāt wa l'adat al-Ta'mīn*, pp. 10-43

³⁶² Lashin, F. (1990), *Sīgha Muqaddamah li al-Sharikat Ta'mīn wa l'adat al-Ta'mīn fī al-Islam*, pp. 95-122

it must spread its indemnity liabilities as widely as possible consistent with safety and security by securing adequate reinsurance protection from a reliable and financially viable reinsurance company.³⁶³ Hence, it is legal for the Takāful operators to place their risks with conventional reinsurers on the basis of *ḍarūrah* (necessity) or *hājah* (dire need) and *al-Maṣlahah al-'āmmah* (general utility). This means reinsurance dealings between Takāful operators and conventional reinsurers must be regulated by the law of necessity, as defined in Islamic law.³⁶⁴

In the early stage of Takāful business, reinsurance facilities were provided by conventional insurance companies due to limitation of Takāful operators, financial inadequacy of Takāful operators, non-availability of retakāful facilities, limitation of retakāful operators, lack of capitalised retakāful operators and lack of 'A' rated retakāful operators.³⁶⁵ Even in this era, some countries use this system to retakāful their Takāful companies.

Based on the following legal maxims, Takāful operators have been permitted to reinsure at conventional reinsurance companies:

1. *Al Ḍarūrah tubīḥ al maḥzūrah* (الضرورة تبيح المحظورات). This principle is accepted among jurists as a leeway in a situation when a Muslim cannot abide to the general rule because of *ḍarūrah* (exigency/necessity). The principle allows Muslims to do what is prohibited in a normal situation or renders an unlawful act lawful.

³⁶³ Arbouna, M.B. (2000). The Operation of Retakāful (Islamic Reinsurance), p. 348

³⁶⁴ Al-Zuhaily, W., *Al-Dawābit al-Shar'iyah li Suwar wa 'uqūd fi al-Ta'mīn 'ala al-Hayāt wa I'adat al-Ta'mīn*", pp. 109-141

³⁶⁵ Zulkifli, A.M., Abd Rahman, B.H., Yassin, N. and Ramly, J (2012). Basic Takāful Practices Entry Level for Practitioners, p. 116

2. *Al ḍarūrah tuqaddar bi qadrihā* (الضرورة تقدر بقدرها). The principle implies that the Takāful operator can only reinsure the risk with conventional reinsurance for the portion of risk that cannot be retakāful by retakāful companies.
3. *Mā ubīḥa lil ḍarūrah yataqaddar bi qadrihā.* (ما أبيع للضرورة يتقدر بقدرها). The principle implies that the extent of necessity limits action there under. This means that even though a jurist allows doing what is prohibited, it should not be excessive in the situation of *ḍarūrah*.
4. *Mā jāza li 'uẓrin baṭala bi zawālih* (ما جاز لعذر بطل بزواله). The principle implies that what is lawful because of *ḍarūrah* will be no more lawful when the *ḍarūrah* is gone. When there is no *ḍarūrah* the law will revert back to the original which is 'reinsurance with conventional operator is prohibited'.³⁶⁶
5. *Al-Hājah tunzil manzilat al-Ḍarūrah khāṣṣatan kānat aw 'āmmah* (الحاجة تنزل منزلة الضرورة خاصة كانت عامة) – Dire need assumes the rule of necessity whether being general or specific.

The two types of retakāful are facultative and treaty. Treaty retakāful can be further divided into proportional and non-proportional. Proportional treaty can be categorised into quota-share, surplus, and facultative obligatory. Similarly, non-proportional treaties can be divided into excess of loss and stop loss.³⁶⁷

³⁶⁶ Zulkifli, A.M., Abd Rahman, B.H., Yassin, N. and Ramly, J. (2012). Basic Takāful Practices Entry Level for Practitioners, pp. 116 and 117

³⁶⁷ *Ibid*, p. 118

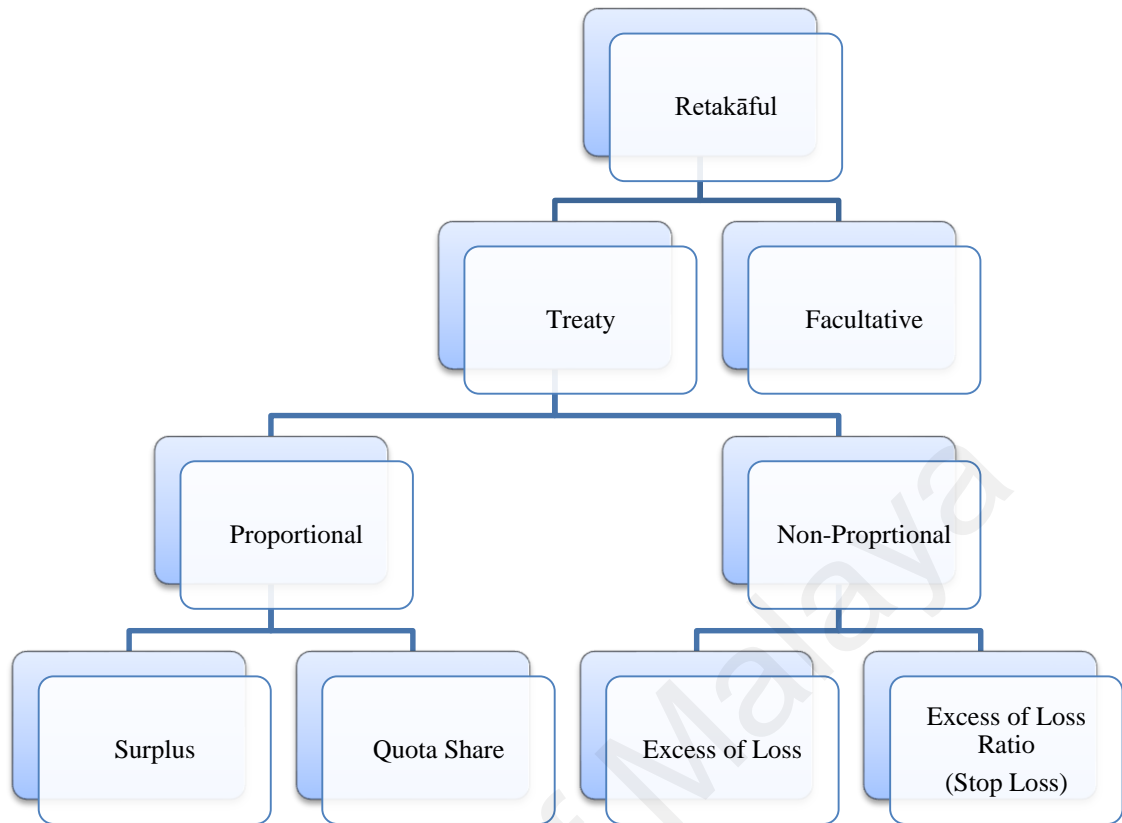


Figure 3.12: Types of Retakāful

Source: Basic Takāful Practice³⁶⁸

In recent years, there has been a significant growth in global retakāful capacity, owing to major reinsurance companies such as Swiss Re, Hannover Re, and Munich Re entering the market. Their entries will help facilitate further expansion of the Takāful market, and the capital support and depth of advice that these players can offer will be invaluable in setting up an operation, wherever the chosen market.³⁶⁹ They entered through the *retakāful* business in several jurisdictions such as Malaysia, Bahrain and the

³⁶⁸ Zulkifli, A.M., Abd Rahman, B.H., Yassin, N. and Ramly, J. (2012). Basic Takāful Practices Entry Level for Practitioners, p. 119

³⁶⁹ Milliman Research Report (2010). Takāful (Islamic Insurance): Concept, Challenges and Opportunities, p. 10

Dubai International Financial Centre. At the moment there are approximately 30 retakāful operators across the globe.³⁷⁰

As a milestone in the retakāful history, Dubai Banking Group (DBG), Khazanah National and Asian Capital Reinsurance (ACR) in 2007 created the world's largest retakāful company with a total capital of \$300 million. The group is operating as a global *Sharī'ah* compliant investment company, focusing on investing in *Sharī'ah* compliant assets in the Islamic sector. The establishment of a successful retakāful market would lead to greater capacity, which would in turn help build the retakāful industry. More solutions would make a positive contribution to the further evolution of a retakāful market.³⁷¹

There are fully fledged retakāful operators like Hannover Retakāful B.S.C © - Bahrain, Takāful Re, Dubai, UAE, Asean Retakāful International Limited (ARIL), Labuan, Malaysia, MNRB Retakāful, Kuala Lumpur, Malaysia, and Tokio Marine Retakāful, Singapore. In the meantime, there are retakāful operators who are functioning as window operations like Munich Re, Retakāful Division, Kuala Lumpur, Malaysia, Labuan Re, Labuan, Malaysia, Converium, Labuan, Malaysia, Best Re, Tunis, ReINDO, Jakarta, Indonesia, Nasional Re, Jakarta, Indonesia and Marein, Jakarta, Indonesia³⁷²

3.3.7 Bancatakāful

Islamic bancassurance or bancatakāful is defined as the distribution of Takāful products by a bank. Bancatakāful functions as the delivery and distribution of a suitable

³⁷⁰ IFSB (2013). Islamic Financial Services Industry Stability Report, p. 33

³⁷¹ Jaffer, S. (2008). Challenges and Opportunities in the Takāful Industry, p. 41

³⁷² Akoob, M. (2007). The development of Takāful & Retakāful, p. 16

range of tailored ‘bankable’ protection and long term savings, education and pension products designed to meet the lifecycle needs of the customer base of a bank or other financial institution.³⁷³

Takāful operators utilise different channels for the selling of their Takāful products. For example: employed sale personnel, independent brokers or telecommunication tools (internet). A distribution channel that is becoming increasingly more popular in conventional insurance as well as in Takāful is the branch network of banks (conventional or Islamic).³⁷⁴

Normally, the bank will partner with Takāful operators to bring bancatakāful plan that offers access to *Sharī’ah* compliant investments with an additional advantage of Takāful cover. This type of Family Takāful plan allows the participant to accumulate his savings for the future and ensures that funds are available for him and his family whenever the need arises. Essentially, it is a provision for *Sharī’ah* compliant protection and investment plan for a better standard of living in the future.³⁷⁵

In simple terms, the bank and the Takāful operator collaborated to come up with bancatakāful product, where both Family and / or General Takāful scheme are offered to the bank’s customers through their branch network. The Takāful operator is the underwriter for these schemes, very much acting like manufacturers of products, and using the bank as a channel to distribute such products.³⁷⁶

³⁷³ Yassin, N. and Ramly, J. (2011). Takāful: A Study Guide, p.241 and Jaffer, S., Islamic Insurance: Retail Bancatakāful Spreads its wings, p. 27

³⁷⁴ Archer, Abdel Karim and Nienhaus (2009). Takāful Islamic Insurance, pp. 17 and 18

³⁷⁵ Yassin, N. and Ramly, J. (2011). Takāful: A Study Guide, p.242

³⁷⁶ Yassin, N. and Ramly, J. (2011). Takāful: A Study Guide, p.242

The number of Takāful companies offering the full range of retail family Takāful products is limited but those who offer such products find banks to be the best distribution channel. As more Takāful companies enter the retail sector, they find, along with banks, that bancatakāful (Islamic equivalent of bancassurance) is an attractive and cost effective way of selling their products. By leveraging their networks to distribute Takāful, banks generate cross-selling opportunities by bundling insurance with other financing products and, therefore, generating annuity fee income. It also allows banks to achieve valuable economies of scale in areas such as marketing, IT, and back-office processes. Similar economies of scale could be made by generating sales leads via referrals through call centres, branch networks and personal bankers.³⁷⁷

There are three forms of bancatakāful models that are currently practiced in the market. The first involves Islamic banks establishing their own subsidiaries, and using these subsidiaries as a means of channelling a range of their own products to the customer base. This model appears to be gaining popularity among a number of *Sharī'ah* compliant banks. This model is favoured by banking giants such as HSBC, which distributes Takāful products to its clients in Malaysia and UK via its global Islamic banking division HSBC Amanah.

The second bancatakāful model is based on the establishment of a joint venture between an Islamic banking unit and a specialist insurance company, with a view to co-designing products that are then distributed via the bank's network. An example for this model is the Takāful joint venture between Ahli United Bank (AUB) of Bahrain and the UK's Legal & General Group.

³⁷⁷ Jaffer, S., *Islamic Insurance: Retail bancatakāful Spreads its wings*, p. 25 and Archer, Abdel Karim and Nienhaus (2009). *Takāful Islamic Insurance*, p. 18

In the third bancatakāful model, the Takāful operator is responsible for product design while the bank acts solely as the distributor. In this model, the product can either be branded as the Takāful operator's product, or it can be branded as the bank's own product. This model is expected to become an increasingly popular option as Takāful's footprint expands in a growing number of countries, including those with sizable Muslim minority population who are currently unable to insure themselves via conventional products due to *Sharī'ah* compliant issues.³⁷⁸

Bancatakāful system is in place in several countries. In Malaysia, successful joint ventures have been established for a number of years. Behind Maybank's Etiqa Insurance Bhd, the country's first bancatakāful player, comes the joint venture between ING and Public Bank in second position and the partnership between CIMB and Aviva in third, evidence of the rapid success of bancatakāful there. In April 2008, the liberalisation of the financial sector brought the issuance of new licences for seven banks, including two foreign players. Those contributed to the growing success of the bancatakāful solution, as it provided opportunities for further alliances.

In Indonesia, the local Bank Mandiri and France's AXA³⁷⁹ set up a joint venture in December 2003 which distributes insurance products to some 265,000 customers through the bank's 700 branches and 1,000 advisors.

Similar initiatives have been launched in the GCC. In November 2008, Zurich Financial Services signed an agreement to establish a joint venture with Abu Dhabi

³⁷⁸ Yassin, N. and Ramly, J. (2011). *Takāful: A Study Guide*, pp.243 and 244

³⁷⁹ AXA is a French multinational insurance firm headquartered in the 8th arrondissement of Paris that engages in global insurance, investment management, and other financial services.

National Takāful. In June 2009, AXA announced its partnership with one of the world's largest Takāful and Retakāful group, Salama in the UAE. Together, they will offer group life solutions to AXA's corporate customers, whose staff will now be given the opportunity to benefit from a comprehensive employee benefits package. In Saudi Arabia, FWU Group³⁸⁰, the global Takāful provider, has a stake in *Al Ahli* Takāful Company and has forged successful distribution partnerships, such as with National Commercial Bank. It has also cast its net wider in the region, by partnering with big players such as Dubai Islamic Bank and Mashreq bank.³⁸¹

Bancatakāful has received mixed reviews, with some products highly successful and others more problematic. Lack of success is usually attributable to factors such as lack of interest on the part of branch management, poorly designed promotions, lack of database integration and marketing and negative attitudes towards change and insurance generally. Bancatakāful has boosted annual global growth of Takāful above 20%, far outstripping the 2.5 per cent annual growth achieved by conventional insurance.³⁸²

Banks and Takāful companies now plan to maximise opportunities through bancatakāful arrangements to reach out to segments that are not captured by the traditional agency forces. According to a Takāful regulator, greater utilisation of bancatakāful arrangements, which leverage the extensive branch network of the banking and development finance institutions, will further extend the reach network of the banking

³⁸⁰ For more than 30 years FWU Group has successfully been leveraging its strength in innovation and its performance management in the investment and life insurance sector. FWU Group has continuously had a track record in creating value for its customers through its linkage with the international financial networks, its top management expertise and it is highly efficient online data systems. As a family owned business with its Headquarter in Munich, Germany, FWU Group's activities are based on social values and the success is the results of linking each part of FWU Group to the next one. Fast and direct communication makes this possible.

³⁸¹ Jaffer, S., *Islamic Insurance: Retail Bancatakāful Spreads its wings*, p. 26

³⁸² Jaffer, S., *Emergence of Bancatakāful worldwide*, p. 5

and development finance institutions will further extend the reach of the Takāful market and promote better product bundling. Currently, all Islamic banks have such tie-ups with local Takāful companies promoting such products as mortgage Takāful and other Family Takāful products to the wide customer base of the banks.³⁸³

Ernst & Young's Global Online Survey 2014 asked respondents about their top distribution channels. The responses show that main distribution channels include brokers (61%) and retail-based channels. Retail-based channels include bancatakāful (57%) and retail agencies (57%)³⁸⁴

In the European countries, bancainurance is a dominant distribution channel with a penetration rate of between 20% to 80% for life and 0% to 10% for non-life. This could be a motivating factor for Takāful operator to push the bancatakāful business for both the family and general product offerings.³⁸⁵

Bancatakāful can only be described as a win-win situation for all stakeholders: The Takāful players get benefits by wide range of customer base of Islamic banks and by providing lower costs. The banks as distributors get advantages by increasing their products and revenue-generating capabilities. Similarly, the customers who are the main factor of marketing, get benefits by having facilities to access a wide range of financial products from the trusted banks. However, though the first signs of improvement are becoming visible, there is still much to be done to reach the top in the Takāful industry.

³⁸³ INCEIF (2012). Takāful – Realities and Challenges, p. 195

³⁸⁴ Ernst & Young (2014). Global Takāful Insight, p. 11

³⁸⁵ INCEIF (2012). Takāful – Realities and Challenges, p. 196

3.3.8 Takāful Regulation and Governance

Takāful is not a contract of exchange of buying and selling. Under Takāful the risk is not transferred to the operator and to be guaranteed by it. It is based on the mutuality and cooperation which is transformed into Takāful models practically. In the meantime, Takāful operator acts as a trustee of participants who have a certain objectives and expectations. In this way, there is a need for regulatory and *Sharī'ah* framework to protect participants and to ensure the *Sharī'ah* compliancy of Takāful operation.

The rules regulating the relations in the domain of Islamic insurance may be of three kinds: 1) rules contained directly in the Holy *Quran* and the *Sunnah*, 2) rules reiterating or developing provisions contained in the Holy *Quran* or the *Sunnah*, and 3) rules that do not contravene the principles of Islamic law. As Islamic insurance in its modern form is a relatively new institution, most rules regulating Takāful relations belong to the second and third groups. Rules concerning Islamic relations may be contained in various legal acts: laws, governmental decrees, circulars, and decisions of individual ministries and agencies.³⁸⁶

3.3.8.1 Legal and Regulatory Framework

Takāful companies need to conform to regulations that have been propagated by their government or regulatory bodies in their operating jurisdictions.³⁸⁷ In Sudan where the world's first Islamic insurance company (Islamic Insurance Company of Sudan) was established in 1979, after the creation of Faisal Islamic Bank of Sudan in 1977, the bank's

³⁸⁶ Bekkin, R.I., National Features and Legal Regulation, p. 119

³⁸⁷ INCEIF (2012). Takāful – Realities and Challenges, p. 213

management started to discuss the idea of establishing an Islamic cooperative insurance company. The Memorandum of Association and the Articles of Association of the company were prepared with an active participation of the Banks *Shari'ah* supervisory council. In accordance with Sudan's Companies Act of 1925, Islamic Insurance Company of Sudan was registered as a public company in January 1979. Originally, the Islamic insurance industry was regulated by the Insurance Supervision and Control Act of 1960. Only in 1983 were clauses introducing Islamic insurance brought into the Civil Code of Sudan. For almost ten years, Islamic insurance had been developing within the framework of the given law, particular the Companies Act of 1925), until in 1992 when a new Insurance Supervision and Control Act was passed.³⁸⁸

In Pakistan, Pak-Kuwait Investment Company acted as the basic shareholder of the first Pakistan insurance company (First Takāful Insurance Company Ltd). The company specialises in banking-related insurance activity aiming at covering the risks connected with trade finance, project finance, and other types of finance. At the same time, life insurance activities had been inconvenient for Takāful companies in Pakistan until Takāful rules 2002 were implemented. A technical support to the new company was promised by other Takāful operators from the Gulf countries, Malaysia, Sri Lanka, etc.³⁸⁹

Takāful rules 2002 of Pakistan provide three models for developing Islamic insurance business in the country: *Mudārabah*, *Wakālah*, and *Waqf* models. Window operations for Islamic life insurance were allowed. Takāful companies are regulated by Securities and Exchange Commission of Pakistan.³⁹⁰ In 2005, The Ministry of Commerce

³⁸⁸ Bekkin, R.I., National Features and Legal Regulation, pp. 119 and 120

³⁸⁹ *Ibid*, p. 121

³⁹⁰ Bekkin, R.I., National Features and Legal Regulation, pp. 122 and 123

of Pakistan introduced Takāful Rules 2005.³⁹¹ The Security and Exchange Commission of Pakistan came up with Takāful Rules 2012 replacing the Takāful Rules 2005.³⁹²

In the same year as in Sudan, the Islamic Arab Insurance Company was established in Saudi Arabia. Earlier, the Standing Committee on Scientific Research and Fatwas had approved the so-called Cooperative Insurance Concept that widely influenced the development of both Islamic and conventional insurance in the country. The company's charter states that its objective is to "conduct cooperative insurance and related operations, such as reinsurance or agency operations, providing that such operations are in compliance with the Islamic *Sharī'ah*".³⁹³ The new Supervision on Cooperative Insurance Companies Act of 2003 reflects this unique situation. It regulates the activity of both cooperative (mutual) and Takāful companies. The main condition for all regulated insurers is the full compliance of their activity with *Sharī'ah*.³⁹⁴

There are several regulatory bodies that govern the practice of Takāful in Malaysia. The main regulatory body, Bank Negara Malaysia (BNM) or the Central Bank of Malaysia is directly involved in the licensing and supervision of Takāful operators. The Takāful Act 1984 was enacted to provide for the registration and regulation of Takāful business in Malaysia and for other purposes relating to, or connected to Takāful.³⁹⁵ As a recent development in the Malaysian regulatory process, Islamic Financial Services Act 2013 (IFSA) was introduced combining the rules and regulations

³⁹¹ Takāful Rules 2005, Ministry of Commerce, Government of Pakistan, p. 1

³⁹² *Ibid*, p.1.

³⁹³ Bekkin, R.I., National Features and Legal Regulation, p. 125

³⁹⁴ *Ibid*, p. 126

³⁹⁵ INCEIF (2012). Takāful – Realities and Challenges, p. 214

for Islamic banking industry and other Islamic financial institutions such as Takāful companies.³⁹⁶

The Malaysian regulatory environment in which the banking, insurance, and Takāful industries are regulated by the same central body, follows that of many developed jurisdictions such as the Financial Security Authority (APRA) and the Monetary Authority of Singapore (MAS). In the Middle East, banks and insurance companies operating in Bahrain and Saudi Arabia are regulated by the Central Bank of Bahrain (CBB) and Saudi Arabia Monetary Authority (SAMA), respectively.³⁹⁷

There are other supervisory bodies and professional organisations that may come into the Takāful regulatory landscape due to the comprehensive components which make up the Takāful practice. These components include *Sharī'ah* and accounting standards, risk management and corporate governance, and investments and financial planning. The few bodies that come into mind are the Malaysian Securities Commission (SC), AAOIFI, IFSB, Malaysian Accounting Standards Board (MASB), and the Basel Committee on Banking Supervision of the Bank of International Settlements (BIS).³⁹⁸

3.3.8.2 *Sharī'ah* Governance Framework

Sharī'ah principles are the foundation for the practice of Islamic finance through the observance of the tenets, conditions, and principles espoused by *Sharī'ah*.

³⁹⁶ Islamic Financial Services Act 2013, an Act to provide for the regulation and supervision of Islamic financial institutions, payment systems and other relevant entities and the oversight of the Islamic money market and Islamic foreign exchange market to promote financial stability and compliance with *Sharī'ah* and for related, consequential or incidental matters.

³⁹⁷ INCEIF (2012). Takāful – Realities and Challenges, p. 215

³⁹⁸ *Ibid*, p. 215

Comprehensive compliance with *Sharī'ah* principles would bring confidence to the public and the financial markets on the credibility of Islamic finance operations.³⁹⁹ Although much work remains to be done in terms of *Sharī'ah* governance, it is market forces that will remain the main driver of the growth of Islamic finance across the globe.⁴⁰⁰

According to guiding principles on *Sharī'ah* governance systems for institutions offering Islamic financial services of IFSB⁴⁰¹ “*Sharī'ah* Governance System” refers to the set of institutional and organisational arrangements through which an IIFS ensures that there is effective independent oversight of *Sharī'ah* compliance over each of the following structures and processes: Issuance of relevant *Sharī'ah* pronouncements / resolutions; Dissemination of information on such *Sharī'ah* pronouncements / resolutions to the operative personnel of the IIFS who monitor the day-to-day compliance with the *Sharī'ah* pronouncements/resolutions vis-à-vis every level of operations and each transaction; An internal *Sharī'ah* compliance review/audit for verifying that *Sharī'ah* compliance has been satisfied, during which any incident of non-compliance will be recorded and reported, and as far as possible, addressed and rectified; and An annual *Sharī'ah* compliance review/audit for verifying that the internal *Sharī'ah* compliance review/audit has been appropriately carried out and its findings have been duly noted by the *Sharī'ah* board.

Islamic financial institutions including Islamic banks and Takāful companies function around the globe in both Muslim majority and non-Muslim majority countries.

³⁹⁹ Bank Negara Malaysia, *Sharī'ah* Governance Framework 2010, p. 1

⁴⁰⁰ Wilson, R. (2011). *Sharī'ah* Governance for Islamic Financial Institutions, p. 1

⁴⁰¹ IFSB (2009). Guiding Principles on *Sharī'ah* Governance Systems for Institutions Offering Islamic Financial Services, pp. 2 and 3

Hence, a few numbers of states have included provision for *Sharī'ah* governance of their banking, insurance / Takāful, capital market and other related operations.

Saudi Arabia, despite its central position in the Islamic world, has no specific legislation on Islamic finance, although adherence to *Sharī'ah* is enshrined in the legal system. Under chapter 1 of its Basic Law it is stated that that the *Qur'an* and the *Sunnah* represent the constitution of the Kingdom and the role of *Sharī'ah* governance is stressed under article 45 which provides for the establishment of a board of religious advisors drawn from the '*Ulama* (the body of educated Muslim scholars). Across the Gulf in Iran the entire financial system has been Islamic since the enactment of the Law on Interest Free Banking in 1983.⁴⁰²

The first Islamic banking law in the GCC was enacted by the UAE in 1985. Under Article 5 provision was made for the establishment of a Higher *Sharī'ah* Authority including fiqh scholars and legal and banking personnel to ensure that Islamic banks, financial institutions and investment companies were conducting their business in accordance with *Sharī'ah* law.⁴⁰³

In the Indonesian legislative provision of 2008, under Article 32 of the Indonesian *Sharī'ah* Banking Act, a *Sharī'ah* Board must be established by each Islamic bank and all conventional banks offering Islamic financial services. The *Sharī'ah* Board members are nominated by the Indonesian '*Ulama* Council, a state body which is in charge of all Islamic matters in the country.⁴⁰⁴

⁴⁰² Wilson, R. (2011). *Sharī'ah* Governance for Islamic Financial Institutions, pp. 2 and 3

⁴⁰³ *Ibid*, p. 3

⁴⁰⁴ Wilson, R. (2011). *Sharī'ah* Governance for Islamic Financial Institutions, p. 4

Sudan and Pakistan also have *Sharī'ah* boards affiliated with their central banks with the power to issue *fatwā* and provide definitive rulings on questions referred to them by the *Sharī'ah* boards or advisors serving Islamic financial institutions.⁴⁰⁵

The BNM places great importance on ensuring that the overall Islamic financial system operates in accordance with *Sharī'ah* principles. This is to be achieved through the *Sharī'ah* governance infrastructure comprising two vital components: a centralised *Sharī'ah* Advisory Council (SAC) at BNM and an internal *Sharī'ah* committee formed in each respective Islamic financial institution (IFI).⁴⁰⁶ In addition, there are several regulatory provisions legalise the *Sharī'ah* governance to ensure *Sharī'ah* compliance when Takāful insurance is practiced. For instance, Takāful Act 1984 is to provide for the regulation of Takāful business in Malaysia and for related purposes.⁴⁰⁷ A new guideline issued by BNM with respect to *Sharī'ah* governance in Islamic banks and Takāful operations, the revised *Sharī'ah* Governance Framework for Islamic Financial Institutions also outlines the *Sharī'ah* committee's functions relating to *Sharī'ah* review, audit, risk management and research as illustrated in Figure 3.13.⁴⁰⁸ Recently, Islamic Financial Services Act 2013 which is included of Islamic banks, Takāful companies and other monetary institutions includes a vital importance to *Sharī'ah* governance.⁴⁰⁹

⁴⁰⁵Wilson, R. (2011). *Sharī'ah* Governance for Islamic Financial Institutions, p. 5

⁴⁰⁶ INCEIF (2012). Takāful – Realities and Challenges, p. 216

⁴⁰⁷ Bank Negara Malaysia, Takāful Act 1984, p. 1

⁴⁰⁸ INCEIF (2012). Takāful – Realities and Challenges, p. 217

⁴⁰⁹ Bank Negara Malaysia, Islamic Financial Services Act 2013.

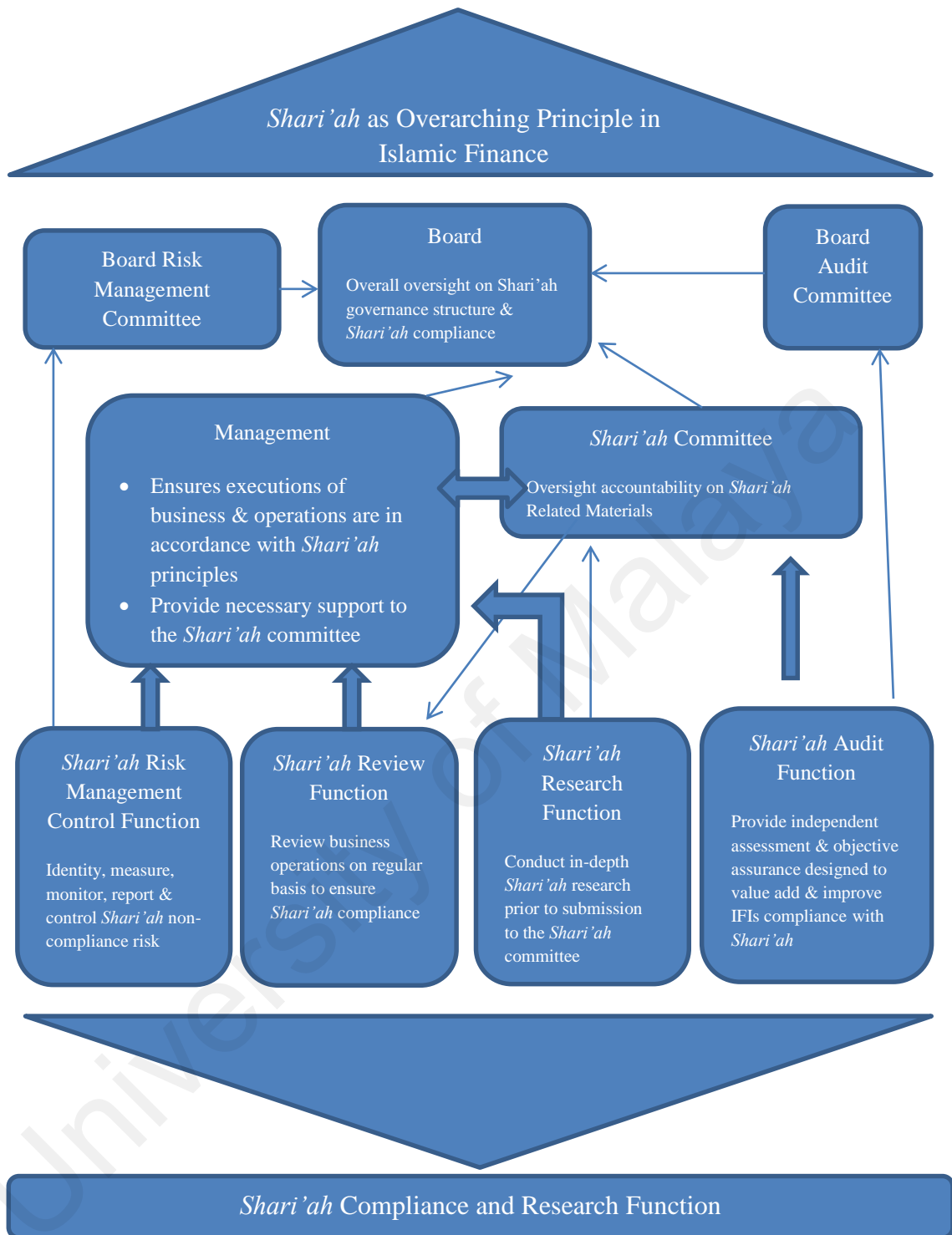


Figure 3.13: *Shari'ah* Governance Framework for IFIs
 Source: *Shari'ah* Governance Framework for Islamic Financial Institutions⁴¹⁰

The IFSB is an institution which provides guidance on the key regulatory issues pertaining to Islamic financial institutions. Its procedures correspond to international

⁴¹⁰ Bank Negara Malaysia (2010). *Shari'ah* Governance Framework for IFIs, p. 08

norms, as its members are consulted on each set of guidelines it produces and there is extensive public consultation. Work on the Guiding Principles on *Sharī'ah* Governance commenced in 2007 and the final draft of the Guidelines became available in December 2009⁴¹¹ namely 'Guiding Principles on *Sharī'ah* Governance Systems for Institutions Offering Islamic Financial Services'.⁴¹²

There are two major bodies which provide international *Sharī'ah* governance, the AAOIFI *Sharī'ah* Board and the OIC Fiqh Academy. The former comprises 14 scholars representing the AAOIFI members, with each serving a four-year term. They have issued *Sharī'ah* standards for most of the major Islamic contracts, which has aided convergence. The OIC *Fiqh* Academy was inaugurated in 1988 before AAOIFI was founded, and considers a wider range of issues, most recently *tawarruq* as already indicated. There is no coordination between these institutions however and, if the international *Sharī'ah* governance infrastructure is to improve, there is a need to determine how the remit of each institution should relate, or perhaps even for a new unified institution to be founded with the support of OIC member states and leading industry players. *Sharī'ah* financial governance has gained increased respect and recognition and the IFSB Guidelines should prove helpful in increasing the credibility of *Sharī'ah* assurance processes. Numerous issues remain to be resolved however, so there is clearly much work to do, although ultimately market forces will continue to be what drives the Islamic finance industry forward.⁴¹³

⁴¹¹ Wilson, R. (2011). *Sharī'ah* Governance for Islamic Financial Institutions, p. 8

⁴¹² IFSB (2009). Guiding Principles on *Sharī'ah* Governance Systems for Institutions Offering Islamic Financial Services

⁴¹³ Wilson, R. (2011). *Sharī'ah* Governance for Islamic Financial Institutions, p. 10

3.3.9 Investment

In line with the rapid growth of the Takāful funds, there is a need for more comprehensive avenues for investment. Better access to the international financial and capital markets need to be opened and enhanced to ensure better returns and spread. This is in concert with the increased globalisation and integration of the financial markets. Legal and regulatory hurdles in cross-border investment activities need to be reviewed as most jurisdictions placed prohibitions for Takāful and retakāful operation. This should, however, be undertaken with a clear understanding of the role of Takāful operators as custodians of public funds.⁴¹⁴

A Takāful operator has a fiduciary duty to ensure that the funds under its management are invested in a prudent and sound manner – avoiding undue risk or loss – to benefit not only the participants but also society at large. A Takāful operator, as a manager of Takāful funds, has to ensure that the payments of Takāful benefits, as defined in the Takāful contract, are efficiently carried out to enable the participants' reasonable expectations to be met. Due to the scale of investments undertaken by a Takāful operator and the effects of these investments on its profitability and risk, the management of these investments is a key function of the operator to create significant value for the Takāful participants and stakeholders.⁴¹⁵

Takāful operators have to ensure that their investment strategy is consistent with the disclosure made under the respective products. Takāful operators also have to

⁴¹⁴ Yusof, M.F., Ismail, W.Z.W., and Naaim, A.K.M. (2011). *Fundamentals of Takāful*, pp. 671 and 672

⁴¹⁵ INCEIF (2012). *Takāful – Realities and Challenges*, p. 161

recognise the importance of separating the responsibilities of managing the Takāful business from the management of the investments backing their reserves and capital.⁴¹⁶

In terms of investment according to *Sharī'ah*, Takāful operators have to put in place appropriate procedures to ensure their investment portfolios are *Sharī'ah* compliant, including procedures for dealing with returns from tainted or non-permissible income sources. The roles of the Takāful operator's *Sharī'ah* committee must be clearly spelled out to ensure effective *Sharī'ah* governance.⁴¹⁷

Certain authorities such as the *Sharī'ah* Advisory Council (SAC) of the Securities Commission of Malaysia and the *Sharī'ah* Supervisory Board of the Dow Jones Islamic Market Index issue guidelines on *Sharī'ah* compliant securities and other financial instruments from time to time. Companies (and even individuals) such as the Takāful operators who wish to invest in *Sharī'ah* compliant securities must often refer to the list issued by them.⁴¹⁸

For instance, the Dow Jones Islamic Market Index articulates that based on the *Sharī'ah* supervisory board established parameters, the businesses listed below are inconsistent with *Sharī'ah* law. The majority of *Sharī'ah* scholars and boards hold that these industries and their financial instruments are inconsistent with *Sharī'ah* precepts and hence are not suitable for Islamic investment purposes. Although no universal consensus exists among contemporary *Sharī'ah* scholars on the prohibition of tobacco companies and the defense industry, most *Sharī'ah* boards have advised against investment in companies involved in these activities. Income from alcohol, tobacco, pork-

⁴¹⁶ INCEIF (2012). Takāful – Realities and Challenges, p. 161

⁴¹⁷ *Ibid*, p. 170

⁴¹⁸ *Ibid*, p. 170

related products, conventional financial services (banking, insurance, etc.), weapons and defense and entertainment (hotels, casinos/gambling, cinema, pornography, music, etc.) cannot exceed 5% of revenue. Companies classified as Financial (8000) according to a unique proprietary classification system are considered eligible if the company is incorporated as an Islamic financial institution, such as Islamic banks and Takāful insurance companies. Companies classified as real estate (8600) according to a unique proprietary classification system are considered eligible if the company's operations and properties are conducting business within *Sharī'ah* principles.⁴¹⁹

Over the years, Islamic financial institutions have begun to tap new growth opportunities in other regions and form cross-border linkages. The range of *Sharī'ah* compliant products and services has also grown, underpinned by an increase in knowledge and awareness of Islamic finance principles. The depth and breadth of Islamic finance instruments have increased from equity to more sophisticated instruments in the capital market such as sukūk or Islamic bonds, Islamic real estate investment trusts and also Islamic derivatives. Islamic assets have grown at an average rate of 15% to 20% per annum over the past decade. Equity easily forms the largest component of the Islamic capital market investments at present.⁴²⁰

3.4 Challenges of Takāful

Despite the impressive growth of the Takāful industry over the last 35 years, there are many issues and challenges facing the industry. Growth of the industry comes with

⁴¹⁹ S & P Dow Jones Indices (2015). Dow Jones Islamic Market Indices Methodology, p. 30, retrieved through https://www.djindexes.com/mdsidx/downloads/meth_info/Dow_Jones_Islamic_Market_Indices_Methodology.pdf on 23rd December 2015

⁴²⁰ INCEIF (2012). Takāful – Realities and Challenges, p. 172

its own set of challenges as the market evolves. While the demand side shows a significant expansion, the supply side faces continuing constraints. Issues regarding the solvency and risk management frameworks feature as key areas for attention by both market participants and regulators. In this context, the IFSB has joined the International Association of Insurance Supervisors in strengthening the supervisory framework to ensure that all the funds within the Takāful operators care are sufficient to absorb significant losses. This is reflected in IFSB-11: Standard on Solvency Requirements for Takāful (Islamic Insurance) Undertakings issued in December 2010, where a solvency framework is recommended to be adopted by Takāful operators around the globe.⁴²¹

A specific issue for Takāful operators is the governance framework in place to accommodate the different incentives and interests of its disparate stakeholders for its Shareholders Fund (SHF) as well as Participants Risk Fund (PRF) / Participants Investment Fund (PIF). A clear separation of responsibilities towards each fund requires careful consideration to avoid any conflict of interest. Strong governance mechanisms need to be in place, as a Takāful company has additional fiduciary responsibilities due to the unique relationship between the Takāful operator and its participants. IFSB- 8: Guiding Principles on Governance for Takāful (Islamic Insurance) Undertakings issued in December 2009, provides a governance framework that serves as a reference for the design of governance structures in different jurisdictions.⁴²²

Another area of continuing debate is that of financial reporting of Takāful operators, a debate that has intensified since the issuance of International Financial Reporting Standard 4 (IFRS-4) which controversially equates the Takāful undertaking

⁴²¹ IFSB (2013). Islamic Financial Services Industry Stability Report, p. 36

⁴²² *Ibid*, p. 36

model with the conventional insurance model. To some observers and participants, there are no technical impediments to IFRS-4.8 However, stakeholders in the Takāful sector have raised concerns over issues relating to the definition of Takāful itself, the treatment of *Qard*, as well as consolidation of both funds (SHF and PRF/PIF). This is an area which requires further careful deliberation by both Takāful operators and supervisory authorities.⁴²³

A further issue is that of the Takāful operator ceding risk to conventional reinsurers. Under the concept of *Darūrah*, conventional reinsurance is permissible if there is limited recourse to retakāful operators in the industry. With the increase in the numbers of retakāful operators in recent years, however, there is a debate as to whether the *Darūrah* concept is still applicable. However, this may be premature, as the diversity of *Sharī'ah* approaches across jurisdictions continues to challenge those Takāful operators who wish to conduct cross-border transactions. Some flexibility is still needed in invoking regulatory impediments relating to *Sharī'ah* interpretations of permissibility.⁴²⁴

Despite the various challenges it faces, the Takāful industry is well placed to continue its remarkable growth given the growing awareness, development of investment linked products and the low penetration rates in Muslim majority countries.⁴²⁵

3.4.1 Lack of Public Awareness

The Takāful industry has been double digit growth in recent years but the desired level of penetration has yet to be achieved. This could be due to the fact that potential

⁴²³ IFSB (2013). Islamic Financial Services Industry Stability Report, p. 36

⁴²⁴ *Ibid*, p. 36

⁴²⁵ *Ibid*, p. 36

consumers tend to downplay the importance of Takāful as they view Takāful as a disguised form of conventional insurance that will enable conventional insurers to gain access to the large Muslim market. Therefore, the prominence of *Sharī'ah* is being ignored. As it is now, Takāful is seen to be sold to consumers rather than being purchased by the consumers. Furthermore, few awareness campaigns are being carried out to educate the mass Muslim population about the role of *Sharī'ah* in the Takāful business.⁴²⁶

Takāful is a knowledge based product and as a relatively new concept ought to be appropriately positioned and widely promoted so as to create the awareness to the public before products are introduced. The information disseminated thus far through the various channels of the media is neither regular, sufficient nor impactful.⁴²⁷

Private Research on behalf of a Takāful provider research found that most of the UK Muslims did not understand the term. Accordingly, companies entering the Takāful business need to educate Muslim consumers about what Takāful is and its *Sharī'ah* compliance.⁴²⁸

3.4.2 Shortage of Expertise and Skilled Staff

As a service industry, the growth and development of Takāful depends upon the quality of its human capital. The sophistication and increased requirement of consumers can only be matched with adequate and professionally trained skilled manpower

⁴²⁶ INCEIF (2012). Takāful – Realities and Challenges, p. 537

⁴²⁷ Sharif, K. (2004). Takāful – Developments and Challenges over 20 years of its existence in Malaysia, p.8

⁴²⁸ Saaty, A.S. and Ansari, Z.A., Takāful – An Islamic Way of Insurance - Developments, Growth, Challenges and Issues, retrieved through www.kau.edu.sa/Files/849/Researches/56402_26701.doc on 29 October 2012, p. 10

including *Sharī'ah*. With the migration of personnel from the conventional industry to Takāful, the need for developing *Sharī'ah*-savvy staff and technical-savvy scholars becomes a critical challenge.⁴²⁹

Scarcity of skilled human resources such as underwriters, actuaries, and investment managers⁴³⁰ is one of the most important issues facing the Takāful industry. It is common to see the same individual moving from one company to another within the industry within a short period. Even though there are attempts to develop expertise in technical areas such as actuarial and underwriting, it will be quite some time before there is an ample supply of human capital that is highly-skilled and well-trained in these areas.⁴³¹

Shortage of well-educated, efficient *Sharī'ah* expertise is also a major problem facing the Takāful industry. Every Takāful company needs to have a *Sharī'ah* board comprising between three and five *Sharī'ah* scholars but the number of available *Sharī'ah* scholars with Takāful and *Sharī'ah* expertise is currently limited. Therefore, we see a number of *Sharī'ah* scholars sitting on more than one *Sharī'ah* board, which could create conflicts of interest that could compromise the quality of advice given.⁴³²

Future growth may also be hampered by the currently narrow pool of professionals with sufficient Takāful knowledge in areas such as law, sales and actuarial services. Most operators would typically employ human resources, such as legal advisors

⁴²⁹ Yusof, M.F., Ismail, W.Z.W., and Naa'im, A.K.M. (2011). Fundamentals of Takāful, p. 670

⁴³⁰ Saaty, A.S. and Ansari, Z.A., Takāful – An Islamic Way of Insurance - Developments, Growth, Challenges and Issues, retrieved through www.kau.edu.sa/Files/849/Researches/56402_26701.doc on 29 October 2012, p. 10

⁴³¹ INCEIF (2012). Takāful – Realities and Challenges, p. 542

⁴³² INCEIF (2012). Takāful – Realities and Challenges, p. 542

and actuaries with conventional insurance experience. These resources would typically tend to learn the *Sharī'ah* aspects of Takāful and adapt their previous experience to incorporate *Sharī'ah* compliance rules in their new role. Hence the mindset of most operators tends to be driven by conventional thoughts and solutions and, as a result there has been limited original thinking in the industry.⁴³³

3.4.3 Regulatory Challenges

There is an absence of appropriate legal and regulatory infrastructure. As can be seen in most jurisdictions, there is no comprehensive legislative and regulatory framework for Takāful. In practice regulations pertaining to Takāful are supplemented within the conventional statutes. Only Malaysia has its own unique framework under the Takāful Act 1984 to regulate, supervise, and license the operation of Takāful.⁴³⁴

Unlike insurance law which has evolved over the past two hundred years, Takāful is still at its nascent stage. The thousands of legal cases in various countries have placed the legal infrastructure of insurance on a firm footing. The need to develop compile and construct a comprehensive body of law in light of the *Sharī'ah* with regards to the Takāful industry is a herculean task that needs to be undertaken. Without this comprehensive body of law, the Takāful industry will be exposed to uncertainties which may affect its long term sustainability. Takāful as *Sharī'ah* compliant entity should operate within the realms of the Islamic tenets.⁴³⁵

⁴³³ Milliman Research Report (2010). Takāful (Islamic Insurance): Concept, Challenges and Opportunities, p. 15

⁴³⁴ Yusof, M.F., Ismail, W.Z.W., and Naa'im, A.K.M. (2011). Fundamentals of Takāful, p. 672

⁴³⁵ *Ibid*, p. 672

Due to the absence of a global Takāful regulatory body, the industry depends on the opinions of the *Sharī'ah* boards of Takāful companies, subject to local regulatory requirements. The approach adopted by the Financial Services Association of the United Kingdom towards the Takāful business and Islamic finance is one of 'no obstacles, but no special favours'. Meanwhile, Malaysia has developed a comprehensive Islamic financial system that operates in parallel with the conventional banking system. The Central Bank of Bahrain has aligned the regulation of Takāful companies with its proposals for conventional insurers.⁴³⁶

3.4.4 Marketing Challenges

Like any other services oriented business, Takāful needs to have in place a comprehensive and strategic marketing plan to ensure that its products and services are able to reach a large section of the consumer public. Moreover, the need for a comprehensive marketing undertaking for Takāful in view of the untapped large population without any form of insurance cover is there. In most developing countries especially member countries of the OIC the penetration rate in terms of population have one form of insurance cover or another is less than 5%. In other words, for every 100 people, less than 5 persons have insurance. Similarly, measured against Gross Domestic Product (GDP) total insurance premium is less than 5%. Only Malaysia has attained a higher penetration rate with more than 30% of its population is insured. It is expected the rate will increase rapidly with the advancement of Takāful, particularly among the Muslim population. As a measure to ensure a steady and orderly growth of Takāful, an effective marketing plan efficiently implemented with precise timeline and diligently monitored must be in place. Guided by SWOT analysis, appropriate strategies have been

⁴³⁶ INCEIF (2012). Takāful – Realities and Challenges, p. 545

mapped out and various actions plan scheduled. To begin with, an appropriate budgeted expenditure for advertising and promotions must be allocated.⁴³⁷

As a service-oriented product, Takāful inherits unique characteristics such as intangibility,⁴³⁸ inseparability,⁴³⁹ heterogeneity,⁴⁴⁰ and perishability⁴⁴¹ that could greatly affect its marketing process especially the type of distribution channel to be utilised. Takāful operators should be fully aware that as an intangible-dominant product, Takāful services are not easily promoted. The intangibility aspect of the product makes it difficult to depict in advertising, whether the medium is print, television or radio. Takāful advertising should thus emphasised tangible cues that will help consumers understand and evaluate the service. The cues may be physical facilities in which the service is performed or some relevant tangible object that symbolises the service itself. Personal selling and contact with the consumer are very important arts of the promotional program for service operators.⁴⁴²

Another important aspect a Takāful operator has to develop in facing the insurance market that is congested with the various insurance companies is the art of positioning. Positioning starts with a product. The process of positioning involves the process of shaping the way customers perceive the product.⁴⁴³

⁴³⁷ Yusof, M.F., Ismail, W.Z.W., and Naaim, A.K.M. (2011). Fundamentals of Takāful, pp. 646 - 655

⁴³⁸ Intangibility - Services cannot be touched, tested or smelled. Hence, the consumers will not be able to view a service product in advance, and may not understand what is being offered.

⁴³⁹ Inseparability - Production and consumption of services are inseparable activities; in other words, they are consumed at the same time as they are produced. An example is a customer purchasing a haircut.

⁴⁴⁰ Heterogeneity - Services involve people and people are all different. Hence, there tends to be variation in the quality of services rendered.

⁴⁴¹ Perishability - Services cannot be produced ahead of time and inventoried. Service perishability will pose problems in terms of demand and supply. On the other hand, physical goods can be produced now for consumption at a later date.

⁴⁴² Sharif, K. (2004). Takāful – Developments and Challenges over 20 years of its existence in Malaysia, p.8

⁴⁴³ *Ibid*, p. 9

The religious compatibility that is directly linked to Takāful products is dear to the heart of many Muslims. Coupled with a quality service and competitive price a Takāful operation should not face any resistance from the Muslim *Ummah*. In this form of niche marketing, Islamic values can positively be used to position Takāful products in facing the Muslim markets. On the other hand, the excellent service, comparatively good product, and competitive price plus some other extra features such as profit sharing (*Maḍārabah*) can attract non-Muslims to participate in the Takāful ventures.⁴⁴⁴ In short, the Takāful industry should be developed as an alternative to conventional insurance. Its services shall be extended to all members of the society not only the Muslims.⁴⁴⁵

As the years progressed, the world faced a range of new risks. Some risks accompanied advancing technology and some have arisen from changes in the legal environment and include potential liability that existed due to environmental change, discrimination in employment, violence in the workplace, interruptions of business resulting from computer failures, privacy issues, computer fraud, electronic larceny, nuclear hazards, malpractice and others. These risks, most of which are insurable, invite the insurance fraternity to develop appropriate insurance coverage to protect the victims from financial losses. Likewise, Takāful operators have to be wary of such risks and their Takāful implications.⁴⁴⁶

⁴⁴⁴ Sharif, K. (2004). Takāful – Developments and Challenges over 20 years of its existence in Malaysia, p. 9

⁴⁴⁵ Saaty, A.S. and Ansari, Z.A., Takāful – An Islamic Way of Insurance - Developments, Growth, Challenges and Issues, p. 10

⁴⁴⁶ Sharif, K. (2004). Takāful – Developments and Challenges over 20 years of its existence in Malaysia, p.10

3.4.5 Other Challenges

Lack of Retakāful Operator: Lack of Retakāful Operators to cater for the need to effectively transfer the risk outside the sector.⁴⁴⁷ Investment Compliance: Lack of *Sharī'ah* compliant investment opportunities.⁴⁴⁸

As technology is business by itself, Takāful industry will face a big challenge in enhancing its operation without the matching of advances in relevant technology. In order to remain competitive Takāful needs to embrace a comprehensive technology advancement in sharpening its operational efficiency, delivery and service.⁴⁴⁹ It is unavoidable using information technology in processing insurance services.⁴⁵⁰ But it should be utilised effectively and efficiently.

Internet marketing or e-marketing is one way of generating Takāful participation. It has become popular as the internet is becoming more widely available and used, especially among the younger generation. The internet allows electronic newsletters or e-brochures to be sent quickly through email and application for insurance coverage to be done online. The online application automatically captures personal, risk, payment details and the like. The downloaded application form can be filled electronically and emailed to the Takāful company.⁴⁵¹ Unfortunately, all Takāful companies which operate all over the globe do not use these facilities properly or underuse them. E-Takāful access is not developed as e-banking does in the financial industry.

⁴⁴⁷ Saaty, A.S. and Ansari, Z.A., Takāful – An Islamic Way of Insurance - Developments, Growth, Challenges and Issues, p. 10

⁴⁴⁸ *Ibid*, p. 10

⁴⁴⁹ Yusof, M.F., Ismail, W.Z.W., and Naaim, A.K.M. (2011). Fundamentals of Takāful, p. 671

⁴⁵⁰ Saaty, A.S. and Ansari, Z.A., Takāful – An Islamic Way of Insurance - Developments, Growth, Challenges and Issues, p. 10

⁴⁵¹ INCEIF (2012). Takāful – Realities and Challenges, p. 198

Lack of standardisation in the Takāful industry due to *Sharī'ah* interpretations is another challenge. As the Takāful industry has only recently been established, there is a wide range of issues currently being debated among *Sharī'ah* scholars and technocrats, particularly those surrounding the definitions and practices that are deemed to be acceptable and *Sharī'ah* compliant. For example, the inconsistency of *Sharī'ah* interpretations can be seen in the issues such as issues in the choice of Takāful model.⁴⁵²

With regards to the nature and treatment of the underwriting surplus of Takāful, there are different opinions among the *Sharī'ah* scholars. Some opine that as the transfer of insurance risk is prohibited, the Takāful operator cannot benefit from any emerging underwriting surpluses. These need to be distributed back to the participants who mutually insure each other. Another opinion on this issue is that the surplus arising is the result of the Takāful operator's sound risk management. Hence, a proportion of the surplus should be distributed to the operator as a reward. Some other scholars opine that neither the Takāful operator nor the participants should benefit from the underwriting surplus as favourable underwriting experience is deemed to be made possible by Allah. Therefore, all emerging surpluses should be donated to charity in the true spirit of Takāful.⁴⁵³

3.5 Conclusion

This chapter concentrated on the theoretical framework of Takāful insurance. It is divided into five parts including introduction and conclusion. Naturally the first part is

⁴⁵² Milliman Research Report (2010). Takāful (Islamic Insurance): Concept, Challenges and Opportunities, p. 18

⁴⁵³ *Ibid*, p. 22 and INCEIF (2012). Takāful – Realities and Challenges, p. 538

introduction and the second part deals with conceptual framework of Takāful. The third part is on the developments of Takāful through various aspects meanwhile the fourth part focuses on the challenges facing the Takāful industry globally.

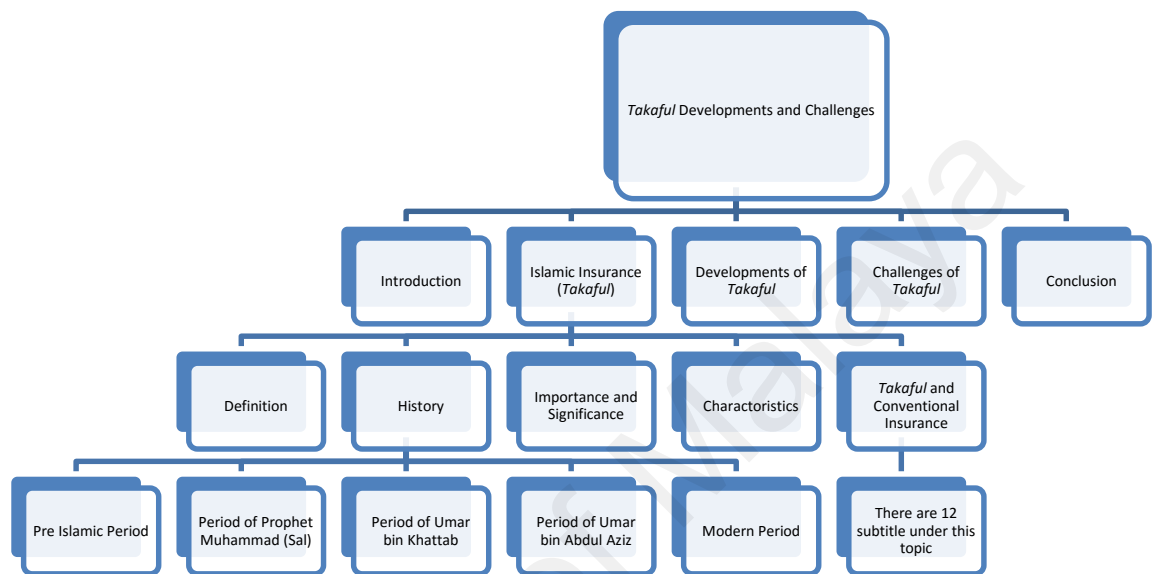


Figure 3.14: Summary of Takāful Developments and Challenges

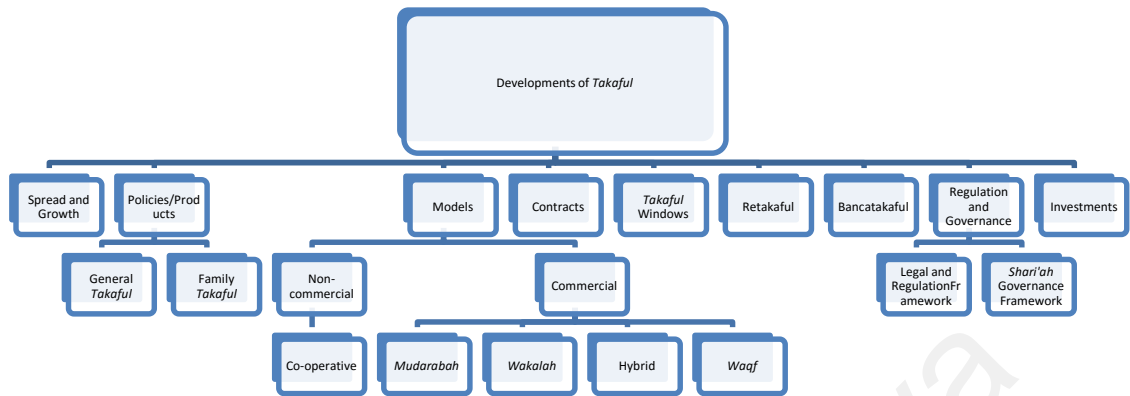


Figure 3.15: Summary of Developments of Takāful

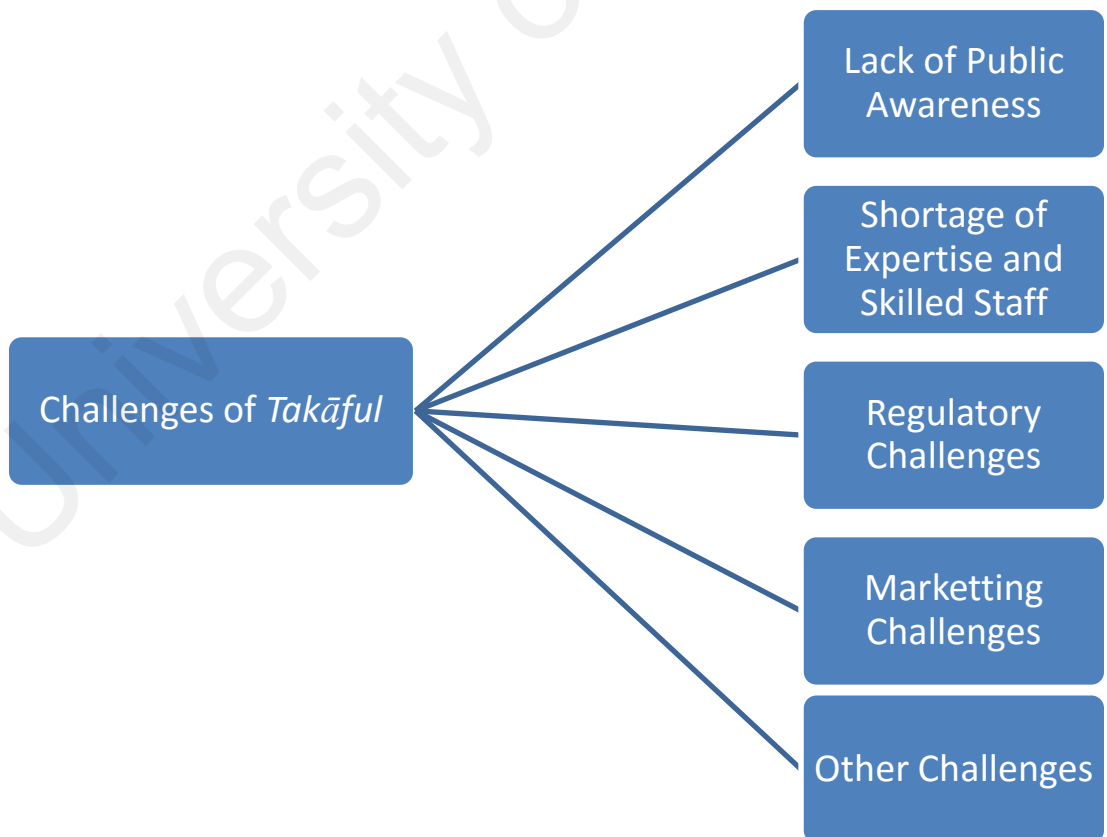


Figure 3.16: Summary of Challenges of Takāful

CHAPTER 4: DEVELOPMENTS OF TAKĀFUL IN SRI LANKA

4.1 Introduction

Development is a specified state of growth or advancement; a new and advanced product or idea; an event constituting a new stage in a changing situation.⁴⁵⁴ Development in a business/company is the creation of long term value for an organisation from customers, markets, and relationships. It is about creating opportunities for that value to persist over the long term, to keep the floodgates open so that value can flow indefinitely. Thinking about business development as a means to creating long term value is the only true way to succeed in consistently growing an organisation.

In view of the above, chapter four focusses on developments of Takāful industry in Sri Lanka. First it explains Takāful companies of the island including Amana Takāful PLC, Ceylinco Takāful Ltd. and HNB Assurance Takāful. Secondly it concentrates on developments and principally elaborates the jurisprudential and business developments before drawing to a conclusion.

4.2 Takāful Companies in Sri Lanka

Sri Lanka is an island country in the Indian Ocean off southeast India. The lucrative spice trade on the island was controlled successively by Arab, Portuguese, Dutch, and British traders from the late centuries before the Christian era. It became a British colony in 1798 and achieved independence in 1948. It was then called ‘Ceylon’

⁴⁵⁴www.oxforddictionaries.com

and was famous for tea, rubber and coconuts. In 1972 the island was declared a republic, and it adopted the name of Sri Lanka.⁴⁵⁵ Since 1978 the island adopted the executive presidential system in the administration of the state.

There are 21 registered insurance companies practicing insurance operations in the country including a fully-fledged Takāful company namely Amana Takāful PLC and a Takāful window namely HNB Assurance Takāful under the HNB Assurance PLC, an established conventional insurance company. There was a Takāful company namely Ceylinco Takāful Ltd. which has been prohibited to engage in Takāful operations by IBSL, the regulatory body for insurance in Sri Lanka.⁴⁵⁶

4.1.1 Amana Takāful PLC

Amana Takāful PLC is the only full-fledged Takāful company in Sri Lanka which provides Takāful services to Muslims as well as non-Muslims. As the pioneer Takāful operator, it commenced its operations in 1999. It is a public quoted company with limited liability incorporated in Lanka on 7 December 1998 and registered (PQ 23) under the Companies Act, No. 07 of 2007 on 27th June 2007. As at the end of the year 2001, there were 10 registered composite insurance companies carrying on both long term insurance business and general insurance business in Sri Lanka. Amana Takāful Ltd, a non-conventional insurance⁴⁵⁷ company, carrying on both long term insurance business and general insurance⁴⁵⁸ business according to Islamic principles, was not regulated at the

⁴⁵⁵Athukorala, Prema-chandra and Jayasuriya, S. (1994). Macroeconomic Policies, Crises and Growth in Sri Lanka, 1969-90, p.2

⁴⁵⁶Insurance Board of Sri Lanka, Annual Report (2014). P. 22

⁴⁵⁷Since there is no *Takāful* regulation under the Sri Lankan insurance regulator, Insurance Board of Sri Lanka, the conventional terms are used for *Takāful* also.

⁴⁵⁸The conventional terms have been used in annual reports of Insurance Board of Sri Lanka as the only regulator for insurance and *Takāful* as well due to unavailability of *Takāful* Act in Sri Lanka

beginning by the Controller of Insurance as it was exempted by the Minister of Finance under the powers vested in the Minister by the Control of Insurance Act No.25 of 1962. As the Regulation of Insurance Industry Act No.43 of 2000 did not confer any power on the Minister of Finance to exempt any insurance company from the provisions of the Act and since there were no transitional provisions permitting the continuation of this Company as a licensed insurer, the Board requested Amana Takāful Ltd. to obtain registration after satisfying all the conditions required under the Act. The Company submitted the application for registration with the request that it be permitted to invest in bullion as in terms of Islamic principles the company is prohibited from investing in interest bearing investments. The Board agreed to take steps to amend section 25 of the Act which deals with the investments of long term insurance fund and technical reserves of general insurance business to accommodate the request made by Amana Takāful Ltd. This company was registered under the Act in February 2002.⁴⁵⁹

The shares of the Company were listed in the Second Board of the Colombo Stock Exchange, Sri Lanka in November 2006. The Stock Exchange Code for Amana Takāful PLC shares is 'ATL'. Its auditors are Ernst & Young, chartered accountants⁴⁶⁰

MNRB Retakāful, GIC Retakāful, Labuan Reinsurance (L) Ltd, Trust International Bahrain, Catlin Labuan Ltd. (Lloyds Syndicate) and Hannover Re are the retakāful panel which provide retakāful services to Amana Takāful PLC.⁴⁶¹

⁴⁵⁹ Annual Report, 2001, Insurance Board of Sri Lanka, p. 6

⁴⁶⁰ Amana *Takāful* PLC, Annual Report, 2014, p. 172

⁴⁶¹ *Ibid*, p. 172

Its *Sharī'ah* advisory council consisted of *Ash-Sheikh* M.M.A. Mubarak – Chairman, *Ash-Sheikh* M.I.M. Rizvi and *Ash-Sheikh* Murshid Mulaffar– Secretary⁴⁶² for consultancy and *Sharī'ah* auditing.

Amana Takāful has affiliations with several firms and companies such as Amana Global Limited, Amana Takāful Maldives, Amana Asset Management Limited, Amana Securities Limited, Lanka Commodity Brokers Limited, IGL Lanka Limited and Amana Capital.⁴⁶³

Amana Takāful Company's Vision Statement is "To be a world class Takāful service provider". They declare that they will benchmark their delivery of value to that of world class service providers in terms of product and services, while upholding the principles of Takāful. And they assure that their delivery will reach all the stakeholders including customers, staff, shareholders, suppliers, regulators and the community at large. Its Mission Statement is "Providing total Takāful solutions within the guidelines of *Sharī'ah* and serving all in an admirable manner".

⁴⁶² Amana *Takāful* PLC, Interim Report, 31st September 2015, p. 13

⁴⁶³ World Islamic Insurance Directory, 2010, p. 233

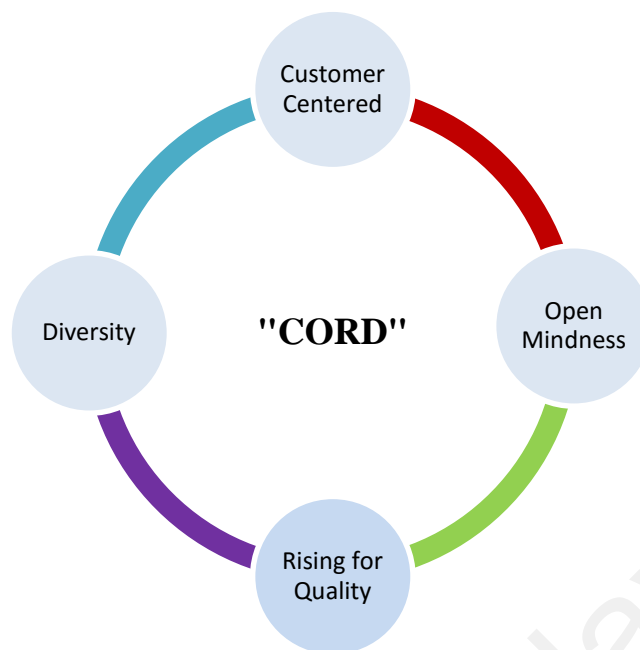


Figure 4.1: Value Statement of Amana Takāful PLC

Source: Amana Takāful Website

According to their Values Statement, as a company and as individuals they introduced “CORD” in 2014. It is a combination of some values as described below:

C – Customer Centred: Working always with the customerfirst every time mindset.

O – Open Mindedness: Looking for better solutions. Demonstrating consolidated and positive emotions and behaviours.

R – Rising for Quality: Our work is a reflection of who we are. I value myself high and therefore my work. Strive to meet and exceed customer expectations.

D – Diversity in everything we do. Embrace our people’s visible and invisible differences, be it age, gender, ethnicity, nationality, religion.⁴⁶⁴. Amāna Takāful has received ISO 9001 accreditation.

⁴⁶⁴ Amana *Takāful* PLC, Annual Report, 2014, p. 02

Amana Takāful PLC incorporated a fully-owned subsidiary, Amana Takāful Life Ltd. on 10 July 2014 to transfer the Family Takāful business with effect from 1 January in line with the requirement to segregate life and general insurance business as required by the RII (Amendment) Act No. 03 of 2011.⁴⁶⁵ Amana Takāful PLC transferred its Life Insurance business to its subsidiary (Amana Takāful Life Ltd) with effect from 1 January 2015 in line with the segregation guidelines issued by the IBSL. Further, proceeds from the Rights Issue of Amana Takāful PLC was utilised to further invest in its said subsidiary, resulting in the Stated Capital of Amana Takāful Life Ltd. increasing up to Rs. 500 million to meet its regulatory minimum capital requirements.⁴⁶⁶ Relevant disclosures to Colombo Stock Exchange (CSE) were also made as appropriate. Accordingly, Amana Takāful PLC is now a general insurance company while Amana Takāful Life Ltd. is a life insurance company 100% owned by Amana Takāful PLC.⁴⁶⁷

Although Amana Takāful PLC commenced its services in a small non-Muslim majority country in South Asia, it contributed to the development of Takāful in other parts of the globe. Zaid Aboobucker,⁴⁶⁸ General Manager/Operation and Medical says,

Amana Takāful has a vital role in developing Takāful worldwide. Earlier there was ASEAN Takāful group within Asian countries including Malaysia, Indonesia and Brunei. I think based on my recollection of events, Sri Lanka is the first non-Muslim country where Takāful operations commenced. Even in India, there are no Takāful companies up until now. We organised a conference for 8EG group in 2003 as we are associate members of the group. About 60-70 people came from countries like Malaysia, Indonesia, Brunei and Singapore. In that conference they passed a resolution to change the ASEAN Takāful group into Asian Takāful group to admit Amana Takāful into the group. Through that we maintained the foreign contacts. After that some participations of Middle East also were there. But our participation was very important. Our presence and

⁴⁶⁵ Insurance Board of Sri Lanka, Regulation of Insurance Industry (Amendment) Act No. 03 of 2011 and Amana *Takāful* PLC, Annual Report, 2014, p. 154

⁴⁶⁶ Amana *Takāful* PLC, Interim Report, 31st September 2015, p. 11

⁴⁶⁷ Amana *Takāful* PLC, Annual Report, 2014, p. 154

⁴⁶⁸ Zaid Aboobucker, General Manager/Operation and Medical, Amana *Takāful* PLC, in the interview held on 19 August 2013.

participation have been there in many Takāful world conferences. Amana Takāful has played an important role to the Takāful industry in the world. From ASEAN to Asian and now it is a global Takāful group.

In conclusion, Amana Takāful PLC plays a dynamic role in developing Takāful concepts and practices nationally and internationally.

4.1.2 Ceylinco Takāful Ltd.

Ceylinco Takāful Ltd. (CTIL) a subsidiary company of Ceylinco Groups of companies started its operations in 2006. CTIL was a new entrant to Takāful business in Sri Lanka. Takāful emerged out of the necessity to have a system of insurance which is acceptable to Muslims, and which is in compliance with *Sharī'ah*. Although the conventional insurance system is more favourable to insurance companies than to the policyholders. The Ceylinco Group wanted to start a Takāful company in order to give people a choice between conventional insurance and Takāful insurance. They already had an established conventional insurance company called Ceylinco Insurance PLC registered under the regulations of IBSL.

Ceylinco Takāful Ltd. collaborated with Shiekan Insurance and Reinsurance Company (SIRCL) of Sudan. Shiekan Insurance in Sudan was established in 1983 and its shareholders are The National Economic Corporation of Sudan, the policyholders, and Khartoum trading & shipping. Shiekan practices the cooperative system of insurance which dictates the distribution of the surplus generated by the insurance operations to the policyholders, characterising the type of insurance as compared to the conventional insurance industry. Shiekan Insurance transects business in all traditional classes of general insurance and specialised risks and in addition to the traditional classes of

insurance, Shiekan also engages in Takāful insurance “the Islamic substitute of the traditional Life insurance”. During its 16 years of active operations (till 2006) Shiekan has established a well-staffed Risk Management and Loss Prevention Department, the first service of its kind in the local insurance market, capturing over 60% in the country.⁴⁶⁹

Ceylinco Takāful established provincial branches in Akurana, Matale, Bandarawela, Gampola, Kurunegala, Puttalam, Chilaw and their head office was located in Colombo and they dealt with Takāful based insurance business in Fire, Consequential Loss, Motor, Marine, Liability, Workmen Compensation, Engineering, General Accident and Miscellaneous.⁴⁷⁰

In a first of its kind action, the regulator, the IBSL temporarily suspended the registration of Ceylinco Takāful Ltd., for failing to submit audited accounts on time. By law, all insurance firms are required to submit the annual audited accounts on a timely manner. Ceylinco Takāful was required to submit the 2006 accounts by June 30, 2007. Owing to the delay further extension was provided but since the Company had failed to meet the extended deadline, the IBSL has temporarily suspended its registration. The initial suspension was for two weeks during which period the Company could submit the audited accounts or explain why the suspension should be lifted.⁴⁷¹

Ceylinco Takāful Ltd. was formerly suspended by IBSL from operating general insurance for three weeks, in 5 August 2009 prohibiting it from issuing new insurance policies in respect of General Insurance, the prohibition was further extended. Finally, on

⁴⁶⁹For more details: Asian Tribune, 2006-12-12, Vol: 11, No: 560, World Institute for Asian Studies, retrieved from <http://www.asiantribune.com/node/3626> on 2 November 2012.

⁴⁷⁰For more details: *Ibid* source.

⁴⁷¹ For more details: <http://www.nation.lk/2007/08/12/busi1.htm> retrieved on 2 November 2012

9 December 2009 IBSL issued a notice further extending the suspension of registration imposed on Ceylinco Takāful Ltd. Regarding general insurance business in terms of section 18 (4) (b) of the Regulation of Insurance Industry Act, No. 43 of 2000 for a period of one year commencing from December 2009 to December 8, 2010.

However the IBSL annual report for 2009 says initially, the Board suspended the registration of Ceylinco Takāful in view of the directors and the principal officer of the company being unable to carry out their functions and adds that thereafter, the company failed to maintain the stipulated minimum solvency margin requirement.⁴⁷² IBSL annual report for 2009 further stated that Ceylinco Takāful Ltd., whose registration is under suspension, and it has requested the Board to grant approval for the transfer of all its shares from its present holding company to another firm. The report concludes that considering the numerous court orders and decisions prohibiting the transfer of shares and assets belonging to corporate members of the Ceylinco Group of Companies, the Board sought the advice and assistance of the Attorney-General to exclude Ceylinco Takāful Ltd. from such orders and decisions.⁴⁷³ Ceylinco Takāful was a part of crisis ridden Ceylinco Group's Ceylinco Profit Sharing Investment Corporation that left away nearly 12,000 depositors with a total of Rs. 800 million funds back in early 2009.⁴⁷⁴ However, the suspension imposed on Ceylinco Takāful Limited in year 2009 continued. Following the Supreme Court Order given on the Fundamental Rights Case No. SC (FR) 191/09, the Board entered into a Memorandum of Understanding (MoU) with Ceylinco Takāful Limited, to initiate a procedure to dispose the assets owned by Ceylinco Takāful Limited for the purpose of settling genuine insurance claims of the company.⁴⁷⁵

⁴⁷²Annual Report, 2009, Insurance Board of Sri Lanka, p. 32

⁴⁷³ *Ibid*, p. 33

⁴⁷⁴Asian Tribune, 2010-11-24, Vol: 11, No: 560, World Institute for Asian Studies, retrieved from <http://www.asiantribune.com/news/2010/11/24/sri-lanka-insurance-regulator-calls-administrator-ceylinco-takaful> on 2 November 2012

⁴⁷⁵Annual Report, 2012, Insurance Board of Sri Lanka, p. 57

In 2010, IBSL called for quotations from persons with financial or legal background with insurance experience to be appointed as an administrator to Ceylinco Takāful Ltd., an Islamic insurance arm owned by former Ceylinco Group. The appointment was to be taken place in terms of section 20 of the Regulation of Insurance Industry Act No. 43 of 2000 to manage and administer the claim settlement procedure of the company.

According to Mohideen (Chartered Insurer), Former General Manager, Ceylinco Takāful Ltd., the reasons for failure of CTIC were mismanagement, commercial motive, unethical activities, corruption, and obstinacy of the head of the team (he was a non-Muslim). The Ceylinco Group's financial crisis was a reason because Ceylinco profit sharing was under same umbrella. The contributions of policyholders of Ceylinco Takāful were mostly invested in Ceylinco profit sharing. It also came under the court case. In profit sharing, they could not return the money till now. The head of the team had utilised the money in various projects. For instance, Ceylinco profit sharing money was used to build a couple of schools i.e. Sussex school. He spent money to build two huge buildings in Horana and Galle. He took an advantage of no interest. If he went to conventional banks, he has to pay interest. Ultimately, when people asked for their money, he did not have money. Because of the allegations, he, along with the chairman, were arrested and remanded.⁴⁷⁶

Ceylinco Takāful had a *Sharī'ah* council consisting of ten '*Ulamas*. The president was late *Moulavi* Salahuddin (Kandy *Moulana*). *Moulavi* Abdul Naser, Secretary, *Jam'iyathul 'Ulama*, *Moulavi* Fazil Farook, *Moulavi* Ahmad from Kattankudy, Riyal

⁴⁷⁶ Mohideen, Former Chairman, Ceylinco *Takāful* Ltd., in the interview held on 22nd August 2013.

Moulavi, Lafir Moulavi from Weligama, Late Niyas *Moulavi* and Yusuf *Mufti* were the members. The head of the management rarely followed Takāful Islamic *Sharī'ah* regulations. That is the worst part of it. He avoided coming to the *Sharī'ah* board meeting to avoid being asked questions. After failing to attend five or six meetings, they sent a warning letter indicating that if he does not attend the next meeting they are going to resign. He did not do anything, so the *Sharī'ah* board resigned.⁴⁷⁷

In conclusion, Ceylinco Takāful Ltd. ceased offering Takāful products due to its failure to fulfil the requirements of the Regulator, IBSL, and the unethical activities of the head of the team.

4.1.3 HNB Assurance Takāful

HNB Assurance Takāful launched its operations on 6 July, 2013 as a window operation under the HNB Assurance PLC, a leading conventional insurer in Sri Lanka. The parent company operates in two units i.e. General and life. These two units are to be separated from next year onwards. Accordingly, they opened non-life Takāful and life Takāful under HNB Assurance as separate units. HNB launched '*Al Najah*' Islamic banking window around the same time because, the Islamic banking unit needs an Islamic insurance arm and vice versa. Based on that need, both initiatives were started.⁴⁷⁸

The annual report of HNB Assurance PLC⁴⁷⁹ reveals that treading along their continuous journey of overcoming challenges and exploring new business avenues, in 2013 they ventured into the business of providing Takāful insurance, which they

⁴⁷⁷ Mohideen, Former Chairman, Ceylinco Takāful Ltd., in the interview held on 22nd August 2013.

⁴⁷⁸ Hifly Huzair, Manager, HNB Assurance Takāful, in the interview held on 24th August 2013.

⁴⁷⁹ Annual Report, 2013, HNB Assurance PLC, p. 82

identified as a market niche with a low level of penetration due to limited service providers in the country. Their business model encompassed this segment in the form of a 'window' operating alongside the conventional life and non-life insurance lines of business, allowing them to serve both retail and corporate clients, and in turn becoming the second Takāful Insurance service provider in the country.

They cater to both life and non-life Takāful needs of their clients, every single Takāful product maintains full compliance with Sharī'ah and is launched only with the approval of the Sharī'ah supervisory board. Their Takāful window is headed by a separate manager and he ensures that all related processes, including underwriting, servicing, fund management and accounting, are carried out in compliance with Sharī'ah principles.

In terms of products, HNB Assurance Takāful focuses on Mortgage Reducing Takāful, which is aimed at homeowners or those who are looking to buy land or renovate a house. On the other hand, HNB General Takāful offers both motor and non-motor Takāful solutions. The non-motor Takāful solutions cover fire, construction, medical, and marine Takāful.⁴⁸⁰

The *Sharī'ah* supervisory board of the company reviewed their Takāful financial statements for the year together with business, accounting and investment processes and has confirmed that HNB Assurance Takāful Window has been operating in line with *Sharī'ah* principles during the period.

Sri Lanka needs more Takāful companies and window operators to provide *Sharī'ah* compliant insurance not only for Muslims but also for non-Muslims. In this process, the first Takāful window, HNB Assurance Takāful started under the umbrella of

⁴⁸⁰ <http://hnbassuranceblog.com> retrieved on 10th December 2015

a well-established conventional insurer, HNB Assurance and there is hope that this window operation will contribute to develop the Takāful industry in Sri Lanka.

4.2 Developments of Takāful in Sri Lanka

Most of the data used to elaborate the developments in Takāful industry in Sri Lanka are related to Amana Takāful PLC because it is the only full-fledged Takāful company that continues its operation up to date. Ceylinco Takāful Ltd. no longer exists and HNB Assurance Takāful is in its initial stage in offering Takāful services.

4.2.1 Jurisprudential Developments

The Takāful industry in Sri Lanka has undergone jurisprudential developments in terms of the model used, standards followed, and local problems encountered in connection with *Sharī'ah*.

4.2.1.1 Takāful Model

Amana Takāful began by using the *Mudārabah* model for their operations following the Malaysian system and have now adopted the *Wakālah* model.

Fazal Gaffoor⁴⁸¹/CEO of Amana Takāful PLC said that they now use the pure *Wakālah* model. The hybrid model was also reviewed but their *Sharī'ah* scholars who weighed the pros and cons of both to conclude that the pure *Wakālah* model should be used. He further expressed,

⁴⁸¹ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013

I have my own view and sometimes I think we have to revisit this model. Times are changing. Because whatever we say, this country is largely about conventional look at IFRS the new accounting standards there is no accommodation of Islamic principles in those. Ribā has to be reported in that way whatever. So, I think to make it easy for the understanding of the regulator, to make easy for us also to operate unhindered.

Amana Takāful PLC follows the *Wakālah* model in their operation in Sri Lanka and the *Waqf* model in their branch in Maldives. It was a branch of Amana Takāful Sri Lanka earlier. But now it is a separate company supervised by the same *Sharī'ah* supervisory council with some additional Maldivian members. At the beginning, when the Muslim community was unable to get Islamic insurance solutions although they were availing Islamic banking facilities through Amana Investment Ltd, The Amana management launched Amana Takāful. But *Moulana* Taqi Usmani, the first incumbent president of the *Sharī'ah* Supervisory Council did not support the *Wakālah* model of Takāful. He intended to start it on a *Waqf* system. Based on his idea, the Maldivian branch of Amana Takāful was established on the *Waqf* model.⁴⁸²

Takāful is a new initiative for Sri Lanka insurance. There is no issue for people who use Takāful as to which model is used so long they get Islamic insurance with a good range of services. If we compare conventional insurance companies as competitors, the *Wakālah* model satisfactorily caters to the needs of people. It also has the feature of surplus sharing. There is no operational or marketing problem in this model for catering to the needs of Muslims or non-Muslims in Sri Lanka.⁴⁸³

⁴⁸² Mubarak, Chairman, *Sharī'ah* Supervisory Council, Amana Takāful PLC, in the interview on 19th August 2013

⁴⁸³ Murshid Mulaffar, Secretary and in-house Supervisor, *Sharī'ah* Supervisory Council, Amana Takāful PLC, in the interview on 19th August 2013

The Chairmen⁴⁸⁴ of the *Sharī'ah* Supervisory Council of Amana Takāful PLC prefers the *Waqf* model for Sri Lanka and had this to say,

I think the people will be satisfied religiously if we implement the *Waqf* model. In Sri Lanka Muslims are religiously inclined they feel that Takāful is the same as insurance. They will be happy if we introduce the *Waqf* system because they will consider this as an '*Ibādah*'. This is why the Maldivians preferred the *Waqf* model which their central bank also agreed.

Ceylinco Takāful Ltd. followed the *Muḍārabah* model in their operations based on the technical advice they got from Sudan. Sudan is the first country to introduce Islamic insurance in 1979. They operated it solely on Islamic principles but they did not call it as Takāful. They called it insurance and reinsurance, but internally all operations were done on purely Islamic lines. They gave technical advice to Ceylinco Takāful Ltd. to follow the *Muḍārabah* model which they adopted. A question was raised against this model by *Moulavi* Nazer, one of the members of *Sharī'ah* Council at the meeting. He explained the weaknesses of the *Muḍārabah* model and submitted a report on that requesting to change the model to the *Waqf* model but no action was taken.⁴⁸⁵ The HNB Assurance Takāful follows a *Wakālah-Waqf* model in their operations.

In summary, the Takāful industry of Sri Lanka follows all the main models of Takāful, ranging from the *Muḍārabah* model at Ceylinco Takāful Ltd., pure *Wakālah* model at Amana Takāful PLC Sri Lanka, *Waqf* model at Amana Takāful Maldives and *Wakālah-Waqf* model at HNB Assurance Takāful. This is a significant feature of the Sri Lankan Takāful scene.

⁴⁸⁴ Mubarak, Chairman, *Sharī'ah* Supervisory Council, Amana Takāful PLC, in the interview on 19th August 2013

⁴⁸⁵ Mohideen, Former Chairman, Ceylinco Takāful Ltd., in the interview held on 22nd August 2013.

4.2.1.2 Takāful Standards

The global Takāful industry includes different operational models, accounting standards, and regulatory regimes. Bahrain, Malaysia, and Pakistan are currently the only markets to have issued specific Takāful laws or regulations. However, in spite of the laudable efforts by the AAOIFI, an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and *Sharī'ah* standards for Islamic financial institutions and the industry is an urgent need. The industry is still in need of a set of global regulatory standards that will be binding on all operators, with certain localisations.⁴⁸⁶ IFSB and BNM also have provided the *Sharī'ah* governance guidelines.⁴⁸⁷

In terms of standards followed by the Takāful companies in Sri Lanka, they unanimously agreed to follow AAOIFI standards due to AAOIFI's world class reputation among the operators and intellectuals. It is notable that the Takāful industry got technical assistance and guidance from Malaysian experts and operators. But they did not utilise standards and *Sharī'ah* guidelines issued by BNM, even though jurisprudential practices according to *Shafi'i* school law are in practice in both countries.

In addition, the *Sharī'ah* Supervisory Council of Amana Takāful PLC has prepared regulations for their jurisprudential necessities. They got special solutions for the problems which AAOIFI standards did not address. For instance, AAOIFI does not mention the *Waqf* model. When they started to implement *Waqf* model in Maldives, they

⁴⁸⁶ Saha, A. (2008). A Primer in the Evolution of Takāful, TATA Consultancy Services, p. 6

⁴⁸⁷ Kasim, N., Nu Nu Htay, S., and Salman, S.A. (2013). Comparative Analysis on AAOIFI, IFSN and BNM *Sharī'ah* Governance Guidelines, International Journal of Business and Social Science, Vol. 4. NO. 15, p. 1

secure legal opinions from leading Muslim scholars including *Moulana* Taqi Usmani and the *Waqf* based standards of Pakistan.

Sometimes, the *Shari'ah* Supervisory Council takes decisions which are a hybrid of *Shari'ah* rules and law of the land. For instance, in family Takāful, in the event of death the procedure for the delivery of the property is a mixture of *Shari'ah* and the Common law of the land, the Takāful company at the time of application, requests participants to indicate his/her *Wasi*. He/she can appoint a nominee like his wife/husband, son, daughter or other person. The *Wasi* should distribute the (the person who passed away) property according to the Islamic inheritance law or the court will interfere and make arrangement to do so. This is for Muslims, for non-Muslims, it is done according to the common law.⁴⁸⁸ In situations such as this, the *Shari'ah* Supervisory Council of Amana Takāful PLC has compiled *Fatwās* as solutions to practical problems.

4.2.2 Business Development

The Sri Lankan Takāful industry is developing rapidly and is confronted with serious challenges from its competitors and the conventional insurance industry. Amana Takāful as the only fully fledged Takāful operator in Sri Lanka. It started its operations in 1999 and is progressing well. Ceylinco Takāful Ltd. commenced its operations in 2006 and unfortunately has been suspended from the registration by the IBSL, the official regulator for insurance industry in Sri Lanka. In 2013, HNB Assurance Takāful, a Takāful window started its operation as a new dimension for the Takāful industry in Sri Lanka.

⁴⁸⁸ Mubarak, Chairman and Murshid Mulaffar, Secretary and in-house Supervisor, *Shari'ah* Supervisory Council, Amana Takāful PLC, in the interview on 19th August 2013.

4.2.2.1 Growth

Financial growth is a noteworthy indicator of development of a company or an industry. The Takāful industry of Sri Lanka shows significant growth through the financial statements and analysis by IBSL.

Amana Takāful PLC has showing smooth and sustained development throughout its history. Table 4.1 indicates the performance of Amana Takāful PLC in gross written premium and market share in the insurance industry of Sri Lanka.

Table 4.1: Gross Written Premium and Market Share of Amana Takāful PLC

Year	Long Term Insurance ⁴⁸⁹	Market Share %	General Insurance	Market Share %
2002	19,439,000.00	0.22	31,783,000.00	0.27
2003	39,990,000.00	0.38	84,842,000.00	0.63
2004	60,658,000.00	0.48	183,581,000.00	1.08
2005	86,272,000.00	0.58	383,425,000.00	1.71
2006	90,895,000.00	0.53	589,067,000.00	2.27
2007	130,986,000.00	0.63	678,013,000.00	2.18
2008	188,406,000.00	0.80	835,188,000.00	2.42
2009	207,097,000.00	0.87	953,798,000.00	2.85
2010	240,156,000.00	0.77	933,193,000.00	2.50
2011	303,786,000.00	0.86	916,754,000.00	2.12
2012	359,919,000.00	0.96	1,125,837,000.00	2.27
2013	1,006,855,000.00	0.47	1,686,462,000.00	1.14
2014	1,399,828,000.00	0.56	1,693,869,000.00	1.03

Source: Annual Reports, 2002-2014, Insurance Board of Sri Lanka

In 2002, long term premium income was Rs. 19,439,000.00. It doubled in the very next year (Rs. 39,990,000.00), after five years, it was more than six times that of 2002. The amount in 2007 was Rs. 130,986,000.00. After another seven years, it recorded

⁴⁸⁹ The terminologies, 'Long Term Insurance and General Insurance' are generally used in the reports of Insurance Board of Sri Lanka in order to indicate 'Family Takāful and General Takāful' where the Takāful industry concerned. This issue persists continuously due to the absence of Takāful Act or separate regulator for Takāful in Sri Lanka.

almost ten times growth than in 2007. In 2014, the long term premium income was Rs. 1,399,828,000.00, which is 72 times that of 2002.

As per general insurance, it was Rs. 31,783,000.00 in 2002. After two years, in 2004 it developed six times (Rs. 183,581,000.00). In the very next year, it was doubled (2005). In 2014, it was four times growth than 2005 (Rs. 1,693,869,000.00). It was 53 times that of 2002.

As indicated in Figure 4.2, the types of insurance developed at almost similar pace.

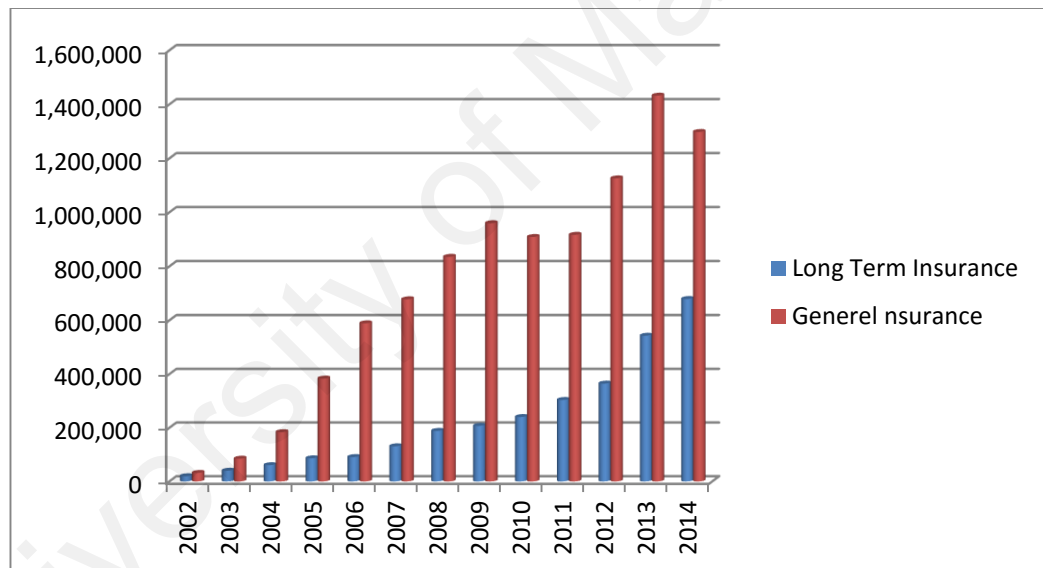


Figure 4.2: Gross Written Premium (Long Term and General Insurance) of Amana Takāful PLC

Source: Annual Reports, 2002-2014, Insurance Board of Sri Lanka

As in Figure 4.3 the market share of Amana Takāful PLC when compared to other conventional insurance operators is very low. It is below 1.00% throughout its history in term of long term insurance until 2013. It is a little higher in general insurance (2.35%).

The long term insurance premium market share started at 0.22% in 2002. It doubled in 2004 (0.48%) and tripled in 2009 (0.87%). In the following two years, there was a drop in the contribution. In 2012, a slight growth was recorded (0.96%). It is first time in the history of Amana Takāful that they reached 1% of market share in 2013 onwards. It is notable here that the conventional insurers of Sri Lanka are contributing over 98% of long term insurance premium in the market.

The market share of general insurance premium started from 0.27% in 2002. It doubled the following year (0.63% in 2003) and has grown four times in 2004 (1.08%). It increased further and rose 1.71% (six times) in 2005. But from 2006 to 2012 there is fluctuation. Interestingly, the market share of 2006 is the same as in 2012 (2.27%). The highest market share of general insurance contributed by Amana Takāful PLC to the insurance industry of Sri Lanka is 2.85% was in 2009. Almost 97% of the general insurance premium is absorbed by the non-Takāful industry of Sri Lanka.

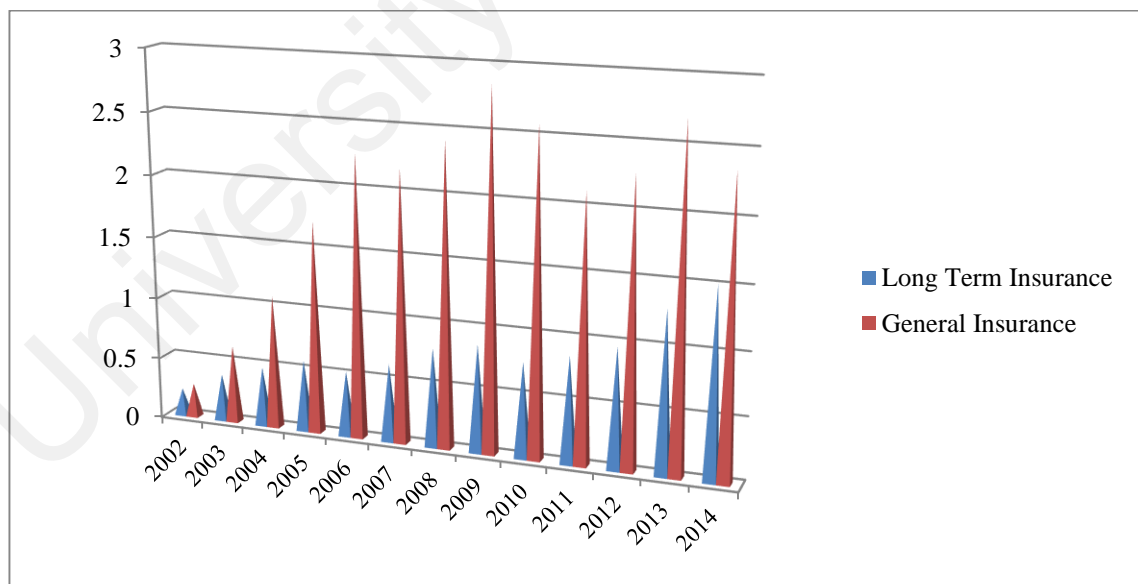


Figure 4.3: Market Share of Amana Takāful PLC (Percentage)

Source: Annual Reports, 2002-2014, Insurance Board of Sri Lanka

When we look at total assets of Amana Takāful PLC, there is clear indication for its development. It began with Rs. 467,302,000.00 in 2006 and grew to Rs. 2,137,687,000.00 worth of assets.

Table: 4.2 Total Assets of Amana Takāful PLC

Year	Long Term Insurance	General Insurance/ Shareholders	Total (Rs)	%
2006	168,031,000.00	299,271,000.00	467,302,000.00	0.40
2007	239,027,000.00	625,937,000.00	864,964,000.00	0.64
2008	313,868,000.00	739,342,000.00	1,053,210,000.00	0.68
2009	369,186,000.00	861,532,000.00	1,230,718,000.00	0.68
2010	486,076,000.00	1,272,986,000.00	1,759,062,000.00	0.79
2011	601,531,000.00	1,360,591,000.00	1,952,567,000.00	0.75
2012	778,592,000.00	1,421,675,000.00	2,137,687,000.00	0.71
2013	1,006,855,000.00	1,686,462,000.00	2,649,064,000.00	0.74
2014	1,399,828,000.00	1,693,869,000.00	2,988,059,000.00	0.73

Source: Annual Reports, 2006-2014, Insurance Board of Sri Lanka

As Figure 4.2 reveals in long term insurance, in 2006 there were assets of Rs. 168,031,000.00. It doubled in four years (Rs. 369,186,000.00 in 2009). It again doubled in 2012 (Rs. 778,592,000.00). And almost doubled after two years (1,399,828,000.00). It is almost eight times of development in the assets between 2006 - 2014. In general insurance, Rs. 299,271,000.00 worth of assets were recorded in 2006. It doubled the next year to be worth Rs. 625,937,000.00. Then there was rapid development in the assets every year until it reached Rs. 1,693,869,000.00 in 2014.

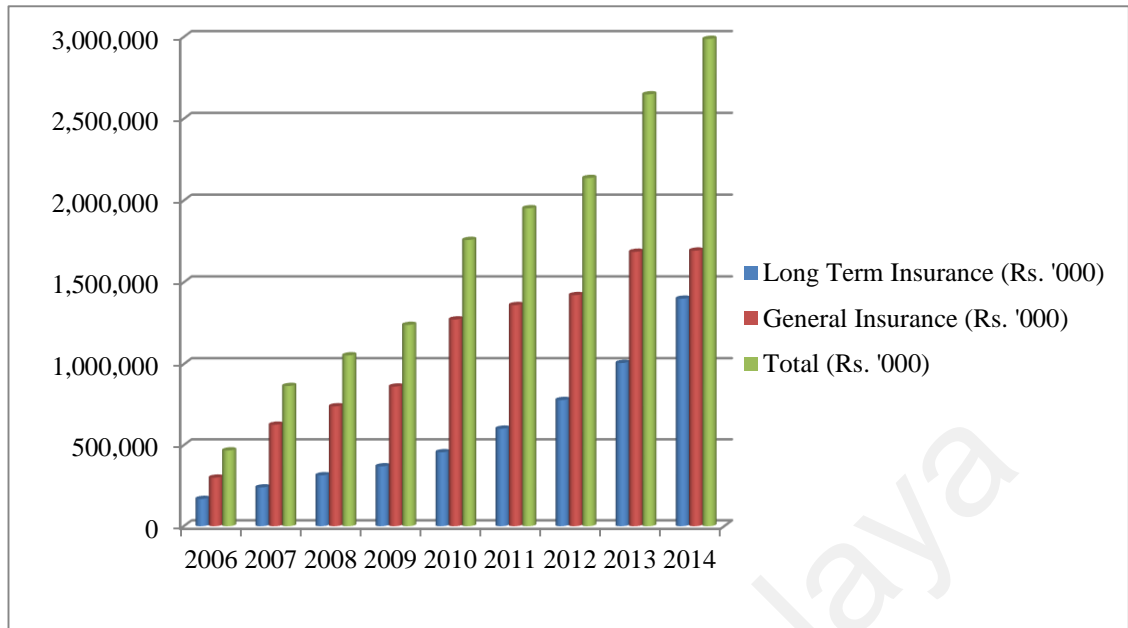


Figure 4.4: Total Assets of Amana Takāful PLC

Source: Annual Reports, 2006-2014, Insurance Board of Sri Lanka

We have to consider here in terms of assets of Amana Takāful PLC that the total assets of the insurance players other than Amana Takāful reached over 99%. It means that the Amana Takāful PLC has not owned even 1% of the assets of the industry. However, there is slight development in the percentage from 0.4% in 2006, 0.64% in 2007 and 0.73% in 2014 (see Figure 4.5).

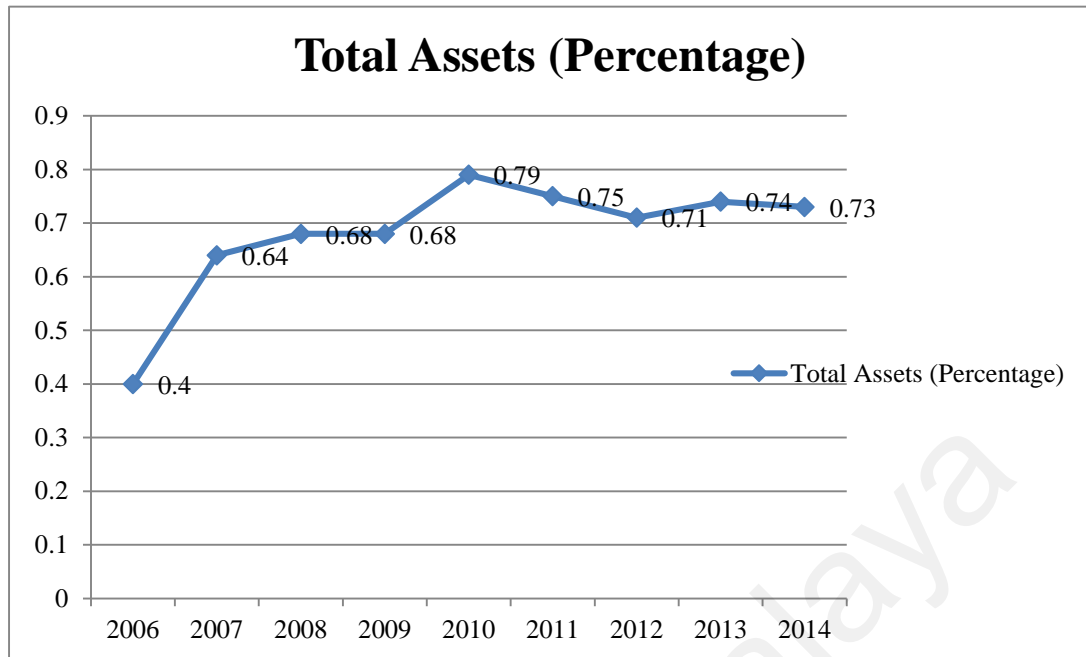


Figure 4.5: Total Assets of Amana Takāful PLC (Percentage)

Source: Annual Reports, 2006-2014, Insurance Board of Sri Lanka

As Table 4.3 discloses, the total shareholders' funds of Amana Takāful PLC are not in a good state. When we compare with other insurance companies in Sri Lanka, shareholders' funds of Amana Takāful PLC is diminishing. It was 2.45% in 2007 and became 0.33% in 2010. And again increased in 2011 and 2012 to 1.43% and 1.19% respectively. In 2013 and 2014, it decreases with 1.04 and 0.89 respectively.

Table: 4.3 Total Shareholders' funds of Amana Takāful PLC

Year	Paid-Up Capital (Rs. '000)	General Reserves (Rs. '000)	Retained Earnings/ (Loss) (Rs. '000)	Other Reserves (Rs. '000)	Total Shareholders' Funds (Rs. '000)	%
2007					478,136	2.45
2008	500,000	-	(80,544)	-	419,456	1.67
2009	500,000	-	(303,560)	5,000	201,440	0.69
2010	500,000	-	(362,009)	-	137,991	0.33
2011	1,250,001	-	(508,662)	-	741,339	1.43
2012	1,250,001	-	(429,266)	-	820,735	1.19
2013	-	-	-	-	983,286	1.04
2014	1,250,001	-	-	-	999,937	0.89

Source: Annual Reports, 2007-2012, Insurance Board of Sri Lanka

When we look at Amana Takāful as an individual company, a clear development has taken place in their performance domain. During the last three years, Amana Takāful has achieved a growth rate twice that of the industry. The industry grew at 15%, while they grew 30%. In 2013, the growth has slowed a little but this could also be a reflection of the economy cooling. The management has a modest plan to achieve a growth higher than that of industry and for the first half, they have achieved that.⁴⁹⁰

At the regional level, Amana Takāful central region branches have doubled the sales in the 2010-2011 period. Their agency cadre and market share also went up. This shows the awareness, the interest of the people in the area, and their satisfaction with the services and other benefits offered by Amana Takāful.⁴⁹¹

In Kalmunai branch, there was a 100% growth in 2012. They undertook community based programmes, women's programmes and children educational

⁴⁹⁰ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

⁴⁹¹ Ifthikar, Regional Manager, Central Region, Amana Takāful PLC, in the interview held on 07th August 2013.

programmes and deployed marketing as a powerful vehicle to achieve the marketing targets. In marketing they used every possible media like newspaper, television, website etc. Through these efforts, the customers were well informed of Amana Takāful and its range of products.⁴⁹²

The Kurunegala branch set a target of Rs. 10 million per month and by the end of December 2013, they achieved Rs. 7 million. The Rs. 10 million was split into Rs. 2.5 million from life and Rs. 7.5 million from general.⁴⁹³

Some analysts who studied the development process of the Takāful industry in Sri Lanka, do not agree with the progress achieved by Amana Takāful PLC as a big achievement, compared to achievements of insurance companies in Sri Lanka. They say the Takāful industry would have moved to bigger targets than what has been achieved at present. One analyst⁴⁹⁴ says:

I do not see a big level development in Amana Takāful. There are some reasons for that. There is a mentality among the majority of people that Takāful is Muslim oriented. It did not capture non-Muslims hearts. There is not even a project to attract non-Muslims. Even among the Muslims there is an attitude that Takāful is merely form of conventional insurance. Due to that perception they prefer any insurance in whatever form that pays claims early and easily. The people are yet not educated clearly that this is *Sharī'ah* based, free from interest, *Gharar* and other prohibited elements. The company also does not seem to have plans to improve this wrong perception. Naturally, only those persons who have strong Islamic values come to this market to avail Takāful services.

⁴⁹² Rahman, Branch Manager/Life, Kalmunai Branch, Amana Takāful PLC, in the interview held on 11th July 2013.

⁴⁹³ Ashik, Branch Manager, Kurunegala Branch, Amana Takāful PLC, in the interview held on 26th August 2013.

⁴⁹⁴ The respondent wants to be anonymous, in the interview held on 24th August 2013.

Statistically, we can see significant financial growth of Amana Takāful PLC as indicated in Table 4.4. Its revenue, gross written premium, net profit or loss, assets, employees and branches are shown in the table from 2007 to 2014.

Table 4.4: Financial Highlights of Amana Takāful PLC

Item		2007 (Rs. Mn)	2009 (Rs. Mn)	2012 (Rs. Mn)	2014 (Rs. Mn)
Revenue		560	865	1,440	2,148
Total Gross Written Premium		809	1,161	1,559	2,373
Net Profit/ (Loss)		(153)	(52)	12	158
General Takāful	GWP ⁴⁹⁵	678	954	1,194	1,973
	NEP ⁴⁹⁶	394	614	969	1,416
Life Takāful	GWP	131	207	365	679
	NEP	118	203	-	665
Total Assets		917	1,227	2,848	3,742
No. of Employees (In numbers)		351	360	380	358
NO. of Branches / Distribution Centres (In numbers)		18	16	22	28

Source: Annual Reports, 2008 – 2014, Amana Takāful PLC

In terms of revenue of Amana Takāful PLC during this period, it has seen progressive growth. In 2007, revenue was 560 million and it doubled during a three-year timeframe. In 2010, it was 1,016 million. From that point, the revenue growth gradually increased. In 2014, it was 2,148 million rupees.

⁴⁹⁵ Gross Written Premium

⁴⁹⁶ Net Earned Premium

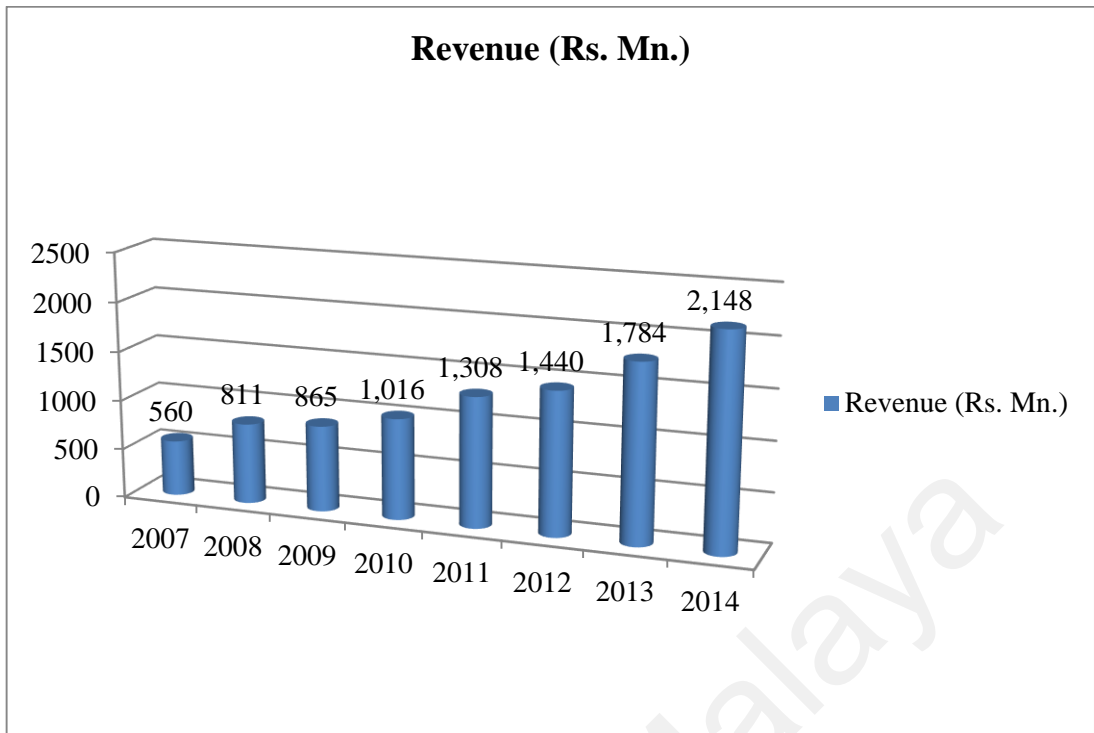


Figure 4.6: Revenue of Amana Takāful PLC

Source: Annual Reports, 2008 – 2014, Amana Takāful PLC

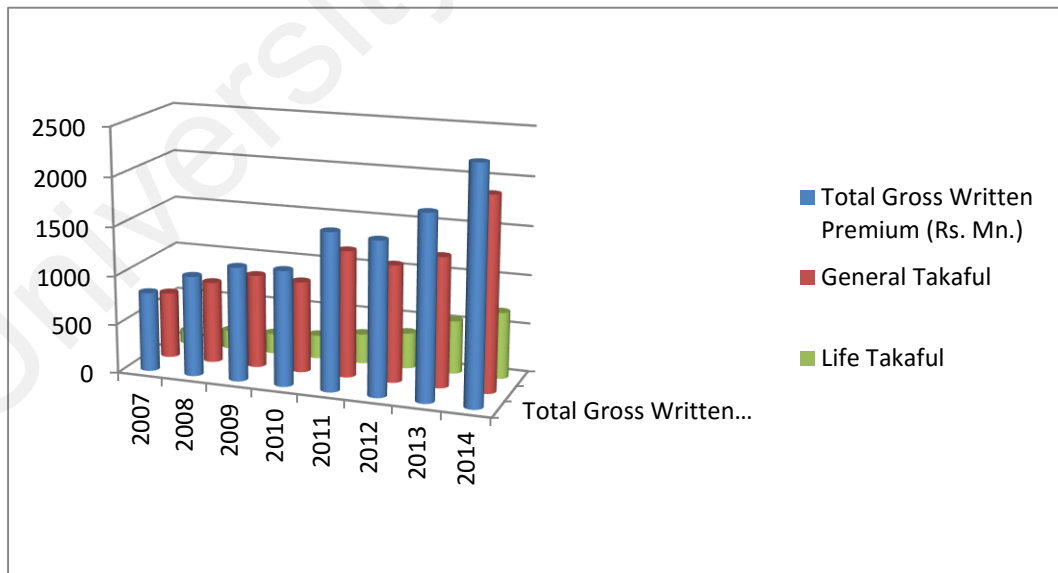


Figure 4.7: Gross Written Premium of Amana Takāful PLC

Source: Annual Reports, 2008 – 2014, Amana Takāful PLC

When we take gross written premium into account, it has a strong indication of growth. Total gross written premium almost doubled in the five-year period, 2007-2012. It further developed in 2014 to 2,373 million.

When we compare general Takāful with life Takāful in terms of gross written premium, there is a significant difference between both. Life Takāful had steady progress during this period while general Takāful had slow progress comparatively even though its amount of money was huge. In 2002, the gross written premium of life Takāful was 131 million. In 2012, it was 543 million with four times of growth. But the gross written premium of general Takāful achieved three times growth during this period from 678 million to 1,973 million.

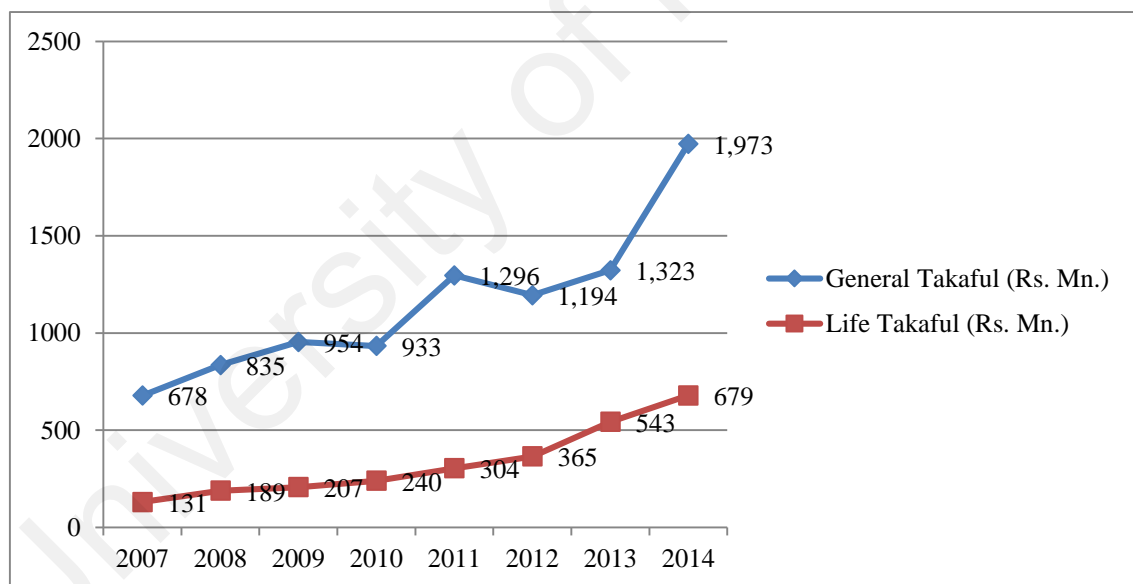


Figure 4.8: Gross Written Premium – General and Life Takāful of Amana Takāful PLC

Source: Annual Reports, 2008 – 2014, Amana Takāful PLC

Net profit or loss is an important business measure for a financial institution. Amana Takāful PLC recorded losses of different amounts until 2011. In 2007 the loss was Rs. 153 million. The company has lost Rs. 373 million during the period of 2007-

2011. As Figure 4.7 indicates, the company reported profits in 2012, 2013 and 2014 with Rs. 12,117 and 158 million respectively. It is an indication that the company is now on the right track and will move to progressive growth in the future.

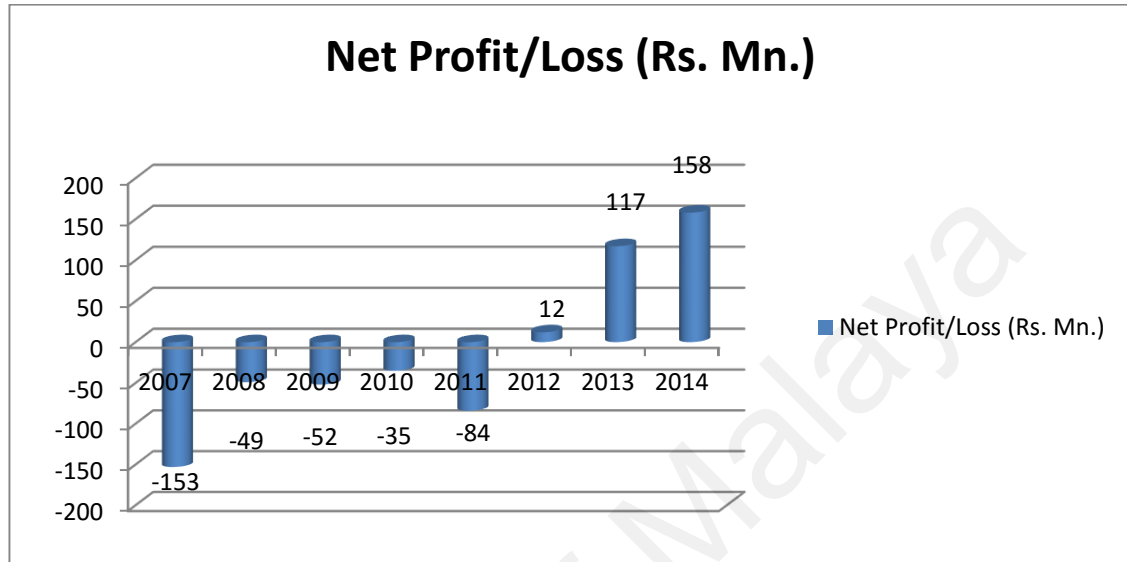


Figure 4.9: Net Profit/Loss of Amana Takāful PLC

Source: Annual Reports, 2008 – 2014, Amana Takāful PLC

As Mohideen,⁴⁹⁷ former manager of Ceylinco Takāful stated, Takāful is in an infant stage in Sri Lanka; it has not as yet developed fully. At present, there are Takāful companies and insurance companies with Takāful windows. Conventional insurance had a 400-year history, many cases have been heard in courts of law and many decisions have been given on the basis of which policy conditions were revised. The long process of evolution has strengthened the conventional insurance process. But in the Takāful industry the evolutionary process has to take place slowly and this is bound to take time.

According to Hifly Huzair,⁴⁹⁸ Manager, HNB Assurance Takāful,

When Amana started, there was nothing called the Islamic financial industry. They started targeting the Muslims on the faith basis. But today in

⁴⁹⁷Mohideen, Former Chairman, Ceylinco Takāful Ltd., in the interview held on 22nd August 2013.

⁴⁹⁸Hifly Huzair, Manager, HNB Assurance Takāful, in the interview held on 24th August 2013

Sri Lanka there is separate industry called the Islamic finance industry. All banks have either started Islamic banking windows or are in the process of starting one. A good example is that, 3 years ago the Islamic banking deposit base was less than 1 or 2 billion. But today it is 30 or 40 billion collectively.

The Islamic banking industry has the potential for speedy development and recognition in Sri Lanka. This progressive development in the Islamic finance industry has enabled the development of the Takāful industry. Both the Islamic banking industry and Takāful industry depend on each another when offering Islamic modes of finance. Their services are very closely intertwined to the extent that they will be seriously hampered if they were to practice separately without getting the assistance of each other.

4.2.2.2 Products

Product development is also an indication of growth of any company including insurance companies. At the inception of Takāful insurance, only six products were provided by Amana Takāful PLC. At present, there are more than 60 products under two main categories. The operators divided them into three main parts. Under the General Takāful there are many products such as Takāful Total Drive – Comprehensive, Takāful Travel Pal, Takāful *Navodaya*, Takāful My Home, Takāful Fire Cover, Takāful easy Marine and Takāful Business Cover. Takāful Prosper, Takāful *Adhyapana*, Takāful *Surakshitha*, Takāful Platinum and Takāful Group Life are under the Family Takāful. Takāful Hale & Hearty Young Minds, Takāful Hale & Hearty and Takāful *Kruthaguna*, *Suwasiri* and Crystalline are under Medical Takāful.⁴⁹⁹

In 2001, there were only the basic products in Takāful like motor, fire, and marine. After that, Amana Takāful introduced a wide range of new products and they added

⁴⁹⁹ Website of Amana Takāful PLC, retrieved on 10th December 2015

several features to existing products as value addition. For example, in the motor Takāful, the price was based on the value of the vehicle, now more benefits have been added. Amana Takāful introduced the no claim protection for the first time in the insurance industry of Sri Lanka. Now all companies in the industry apply this as a no claim bonus. Amana now has 65 products. If we compare this product range to other insurance companies, it is clear that Amana Takāful has alternative Islamic offers for over 95% of the products available in the insurance industry. As a general observation, there is good development in the family Takāful product range.⁵⁰⁰

At inception Amana Takāful used the term ‘family Takāful’, now they use the brand ‘life Takāful’ because people do not properly comprehend the new (family Takāful) terminology.

According to Fazal Ghaffoor,⁵⁰¹ CEO, Amana Takāful PLC plan to get into non-motor Takāful in a big way,

In Sri Lanka two third or more of the general insurance of the non-life, is the portfolio of motor. Now motor insurance unfortunately is not business that you can reinsure. There is no reinsurance and the claims of motor insurance are phenomenal. In motor there are legitimate claim and claims which are bogus which is really out of control. There are also claims arising from border line cases When two third of your portfolio is motor and the claims are larger than your revenue, what needs to be done is basically to broad base the portfolio. And towards this end Amana Takāful is looking at non-motor segments of the business which we call non-motor business. That is working quite well but not at the speed I would like it to grow. But we are working on that basis.

Ellobarating the need of the present era, he⁵⁰² further said that they will give preference to medical Takāful,

⁵⁰⁰ Zaid Aboobucker, General Manager/Operation and Medical, Amana Takāful PLC, in the interview held on 19th August 2013.

⁵⁰¹ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

⁵⁰² *Ibid*, in the interview held on 19th August 2013.

We are also looking at expanding medical business. Because today there is high investment in private medical care and hospitals are being opened in many parts of the country. The government is planning to scale down the massive health bill that they have to deal with. They cannot run on being welfare state all the time. So, we are trying to see what is the optimum level, we can stretch with innovative products and services. The medical business was very profitable last year. We have plans to expand this business, with the reasonable controls, over the next three years. And I think this calls for an industry-wide level of awareness for people, it also calls for the supply chain partners right through the pharmacies, the people who do laboratory tests and the medical professionals themselves to come forward and lay down minimum threshold standards on these. Because the cost of medical care varies significantly from place to place, from junction to junction, from hospital to hospital. That is one. Second thing is the control element. We had a few unfortunate issues in our claims. People have to realise this. All insurance companies have targeted large corporates. So, we go to the public. We conduct education programmes, life time programmes for them and we service them and to every plan there is a surplus of the medical fund, we share the surplus which is really the tenet of Takāful.

The key for the development of the products is in the correct brand naming. At inception, Amana Takāful used to name the product using English terminology. In the recent past, they changed this policy by brand naming in the Sinhala language which is the mother tongue of the majority of Sri Lanka. This is closer to their heart and to the feeling of nationalism. M. Fazal Gaffoor,⁵⁰³ CEO, Amana Takāful PLC expressed his view in this connection stating,

Most of the portfolio products when I came on board were named in English. What did this mean to our population here? So, we launched a product for hospitalisation, we called it '*Kruthaguna*'. This Appeals to everybody. We had a child policy called "educate". I said make it '*Adhyapana*'. Because it is a Sanskrit word which cuts a root for Hindus, Muslims, Sinhalese and all of them. So our policy is to use brand names to suite the place and the market".

Amana Takāful takes care of the people who are in the lower levels of society and who are economically marginalised, by introducing micro Takāful product called '*Nawodhya*'. The CEO⁵⁰⁴ explains that Amana Takāful tries to step into micro Takāful

⁵⁰³ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

⁵⁰⁴ *Ibid*, in the interview held on 19th August 2013.

by giving people support for their immediate needs. The product called '*Nawodhaya*' is micro Takāful.

Amana Takāful introduced their latest policy '*GuruthaGuna*', an insurance cover designed to take care of the hospitalisation of the elderly. It gives the participant the peace of mind to spend time with them, to love them and care for them. It provides the participant with financial security and much needed support in times of need. It is the only product of that type in the insurance industry in Sri Lanka.

Takāful products of HNB Assurance Takāful, focus heavily on mortgage reducing Takāful, which is aimed at homeowners or those who are looking to buy land/renovate a house. On the other hand, HNB General Takāful offers both motor and non-motor Takāful solutions. The non-motor Takāful solutions cover fire, construction, medical, and marine Takāful.⁵⁰⁵

Muath, Head of Finance and Corporate Strategy, First Global Group, Colombo, explains the importance of introducing new products. He⁵⁰⁶ says,

The main idea in the conventional insurance is selling the policies. As a company it will get some money and it can make multi-millions out of them. That is their motive. But here, we have something totally different. We always think about the other people those who are injured, those who are not involved in risk or peril situation. We want to help each other. The brotherhood we are talking about here is not only the Muslims but also non-Muslims who choose to use this concept. In conventional insurance we can find a limited number of products only. But in Takāful, we can do lots of things. Even starting from the major, mega Takāful to micro Takāful. There are some case studies which one can get from Muslim Aid and Amana Takāful. They have done micro Takāful. The moment people understand the value proposition that you going to bring to them they will be ready, they will be ready for it.

⁵⁰⁵ Website of HNB Assurance, retrieved through <http://hnbassuranceblog.com/2015/02/05/hnb-assurance-takaful-in-a-nutshell/> on 10th December 2015

⁵⁰⁶ Muath, M.B.M., Head of Finance and Corporate Strategy, First Global Group, Colombo, in the interview held on 26th August 2013.

Further he⁵⁰⁷ explains the potential for Takāful through introducing new products that here is huge potential for Takāful in the country after 30 years of war. We are building now. Not only building, we are having the mega infrastructure projects that are going on. For example: southern express way or northern express way or Colombo-Kandy or Katunayake express and the large number vehicles are going to come in to us them. We are talking about vehicle insurance here. And also we talk about the malls/shopping malls and few new things that will come in. Marine Takāful is another area when we can talk about harbors and airports. All these mega infrastructure projects are going on. These are opportunities we can talk about not only to Sri Lankans but even to the outsiders those who are coming/visiting Sri Lanka, for a shorter period. They will need this insurance cover. So I would say it has huge potential. Not only in Sri Lanka, but we can talk about Maldives and countries in the region as well. Especially, we can talk about Middle East and others those who are travelling to Sri Lanka, those who are concerned about their health, we can have separate insurance policy for them also.

He⁵⁰⁸ further elaborates,

In terms of development, the concepts to be developed and we should have more products. We have only the theoretical products which are available in the market as well. But there are certain needs which we really need to the market. The people those who are getting enrolment to the university, slight they are not getting in to it. We must have a product for them, Muslim and non-Muslims. And we need a product for job cuts. Recently 750 people job cut from the Fonterra Company. It is problem of not 750 people but it is the problem of 750 families. But we have vehicle, education normal products now. We can have some sort of product development. Do we have some combined products for the best value proposition? For an example: I am going for a vehicle loan, the people of Amana Takāful and Amana bank have a combined product. We need to act fast. I would say. We can introduce a policy for farmers also.

⁵⁰⁷ Muath, M.B.M., Head of Finance and Corporate Strategy, First Global Group, Colombo, in the interview held on 26th August 2013.

⁵⁰⁸ *Ibid*, in the interview held on 26th August 2013.

In addition to that, there are online facilities to buy *Takāful* products. And also, the online access is available for the participants to check their claim status, renew the contract of participation, pay through bank, check their fund balance and get quotation. This is a tremendous development in the *Takāful* industry in Sri Lanka.

In a nutshell, product development of *Takāful* industry in Sri Lanka is magnificent. But there is a lot to do to introduce new products catering for the necessities of the people.

4.2.2.3 Investments

Investments are the cornerstone of any financial institution as they generate the vital source of income. It is a critical area for insurance. The *Takāful* operator is restricted in this area and is compelled to invest the contributions of participants only in the *Sharī'ah* compliant investment options. It is here that they face multiple challenges in practice. As a mandatory requirement, they have to invest a specified portion of the premium in government treasury bills as directed by the Insurance Board of Sri Lanka, the regulator for insurance in Sri Lanka. This restricts maximum utilisation of investment funds and are further limited to using *Sharī'ah* compliant investment options which are limited within Sri Lanka.

The CEO⁵⁰⁹ of Amana *Takāful* says,

Now whether the funds are performing up to expectation all depends on the instruments which we have invested in. As a *Takāful* company, we have choices, but in actual fact no choices at all. We have to put a minimum investment in treasury bills. 30% in general and 20% in life. Then we have Bullion, real estates, and investments in Banks that have Islamic windows. But there are investment caps for each category which is the maximum that have been offered by the IBSL, the regulator. Bullion has also the maximum we have used it to the maximum. Unfortunately for us Bullion is volatile.

⁵⁰⁹Fazal Ghaffoor, CEO, Amana *Takāful* PLC, in the interview held on 19th August 2013.

Equity also has restrictions as we have to examine the white list. These are companies who are more conducive to the way the *Sharī'ah* issues are managed. If you look at a company which trades in alcohol, tobacco, who have a lot of income from *Ribā*, whose business is harmful to society then in our view we cannot invest in them. We go only to what are the white listed companies which are agreed and signed by the *Sharī'ah* advisory council.

Murshid Mulaffar⁵¹⁰ explains investment matter,

In brief, in investments, we have four or five avenues only. It is a mandatory requirement for all insurance companies that 30% of life insurance premium should be invested in treasury bills as well as 25% of general insurance premium should be invested in treasury bills. If we said 'No' for this, we cannot start an insurance company in Sri Lanka. Therefore, there is clearly in Fiqh *الضرورات تبيح المحظورات* (Necessities permit the prohibited) and *الضرورات تقدر بقدرها* (Necessities are restricted by them and should not transgress them). As a necessity, the people need an Islamic solution for insurance and the company was started. We must notice *تقدر بقدرها* the necessities should not be exaggerated. We have regulations here that we have to invest the mandatory percentage in the treasury bills. To invest more than prescribed percentage you have no permission without a valid reason. If they forwarded us a valid reason, we decide on the validity to permit them another 10% or 5%. The *Sharī'ah* council are the decision makers in this matter. The interest outcome of this investment, we gave them a solution to give this on charity. Treasury bill is the first investment avenue. Second is equity i.e. share market. In White List companies⁵¹¹ - after a screening process, the *Sharī'ah* council permitted some companies - We have to prepare the guidelines for screening and we have a company called Amana Asset Management Ltd., they do the screening process and forward it here and Takāful invest in white listed companies. Third one is Bullion. Amana has a company called IGL Lanka to handle Bullion. We have given guidelines for these investments in writing. Fourth one is fixed deposits. We have Islamic banks or windows. Amana Bank is a full-fledged Islamic bank or Bank of Ceylon, Commercial bank, Hatton National Bank, LOLC and more have Islamic units. They invest in these banks but there is a limitation imposed by the regulator. Fifth is real estates. There are no issues in real estates. Amana Takāful's investment deals with these five avenues. The problem issue is only in treasury bills.

⁵¹⁰ Murshid Mulaffar, Secretary and in-house Supervisor, *Sharī'ah* Supervisory Council, Amana Takāful PLC, in the interview on 19th August 2013.

⁵¹¹ Amana Asset Management Ltd., one of the group companies carrying out the screening process with the involvement of *Sharī'ah* scholars. There is clear guidance from the scholars that a screening has to be carried out in order to identify what the permissible stocks are, which is called the 'White List'. To determine their eligibility for investment, stocks are screened to ensure that they meet the standards set put in the published methodology. In order to be part of the White List, companies must exclude certain non-acceptable products, business activities, certain type of income and expenses and meet certain levels of ratios from the assets and liabilities. This exclusions and limitations are considered healthy for the organisations and thereby to the investors as well.

The secretary and in-house *Sharī'ah* supervisor⁵¹² further says, sometimes, economic circumstances require special solution be taken to overcome the problem. For instance: if the share market is down, real states business also down, Bullion also is also not favourable and then circumstances compels us to safeguard people's money. In such circumstances, we will authorise investment in treasury bills. We do this in consultation with *Moulana* Taqi Usmani, Hasan Khalil and 'Ulamas of South Africa. There is no permission for foreign investment in Sri Lanka. If it is there, it will be a huge relief from the perspective of managing the investment portfolio”.

In HNB Assurance Takāful, the investment story is different. As they are operating on the basis of a window of a conventional insurance company (HNB Assurance) the restrictions imposed by IBSL is common.

Hifly Huzair,⁵¹³ Manager, HNB Assurance Takāful explains,

In the investment, there are several categories. One is stable fund. We go for stable account. Because, in this initial stage, we cannot take a risk and we do not have big amounts to spread the risk factor. In this sector Islamic investment is very limited. Either we have to go to the White List or we have to go to the Bullion market or to the stock market. As a company we have certain policies. According to that we are not investing in leasing companies. At the moment we are going for a stable investment portfolio and this means investing in the HNB Islamic window. We can explore new options when the fund increases in size and capacity. We are part of HNB Assurance but operating as a window. Sri Lanka at the moment has no law separately for Takāful. The Law as it exists today was enacted for conventional insurance. In summery the situation is that, Amana can call them Takāful or Islamic insurance, but the IBSL regulator recognises Amana as another insurance company due to unavailability of special regulations for Takāful. At the same time, we are part of HNB Assurance, we have the same rule where we have to go by rules and regulations of IBSL. As we are a window operation, we are not entitled to deposit a portion in security bonds of CBSL. Amana has this problem, because they are a separate entity.

⁵¹² Murshid Mulaffar, M., Secretary and in-house Supervisor, *Sharī'ah* Supervisory Council, Amana Takāful PLC, in the interview on 19th August 2013.

⁵¹³ Hifly Huzair, Manager, HNB Assurance Takāful, in the interview held on 24th August 2013.

4.2.2.4 Participants

In any business enterprise a stable customer base is a very important element. Without customers, there will be no company. The rapid growth of number of customers is a good indication that the company grows progressively.

In 2001 there was a substantial number of customers in general Takāful of Amana Takāful. In family Takāful the number ranged between 2000-3000 customers. Presently in general there are about 40-50 thousand clients.⁵¹⁴ 10,489 family Takāful (life) certificates were issued in 2013.⁵¹⁵

Sri Lanka is a multi-religious and multi-ethnic country. More than 90% of its population is non-Muslims. The Takāful industry in Sri Lanka should not aim at Muslims only, non-Muslims must be a critical component of the Takāful initiative. According to Fazal Gaffoor,⁵¹⁶ CEO, Amana Takāful PLC, when the company was started it targeted the population which looks for *Shari'ah* compliance and naturally Muslims became the target market. Over time, when they got the insurance license and became a fully-fledged composite company that is selling general insurance, life insurance, and medical insurance etc. they refocused marketing strategies cutting across cast or creed. Today they have more than 35%-40% of customers who are non-Muslims. Many non-Muslims are beginning to understand and appreciate Takāful principles and by choice subscribe to Takāful insurance. Amana Takāful is targeting all sections of society and its operations are now aimed at the entire Sri Lankan population.

⁵¹⁴Zaid Aboobucker, General Manager/Operation and Medical, Amana Takāful PLC, in the interview held on 19th August 2013.

⁵¹⁵ Annual Report, 2013, Amana Takāful PLC, p. 5

⁵¹⁶Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

In the central region of Sri Lanka, non-Muslim participation is booming. According to Ifthikar,⁵¹⁷ regional manager of Amana Takāful for central region, even though the Muslim population is about 8-10% in the central region, 60% of their participants are non-Muslims. Ashik,⁵¹⁸ Branch Manager, Kurunegala branch, Amana Takāful PLC says that he studied at a non-Muslim school, and grew up in the non-Muslim environment. He promotes to non-Muslims as well. He has confidence that he can give the same quality of service as conventional companies. To the customers, if they pay the premium, and get claims on time, it is enough for them. They do not look into the system, profit ratio etc. In the Kurunegala branch, nearly 55% of customers are non-Muslims in the general segment. In the life segment, non-Muslims do not show much interest because they get a better interest based return in conventional insurance companies.

Ceylinco Takāful initially took up the position that Muslims were the customers of Takāful. They did not take measures to reach out to the non-Muslim market because of they felt that they had Ceylinco Insurance Company for that segment of the market. They targeted only the Muslims with a commercial motive.⁵¹⁹

Non-Muslims have a strong awareness of insurance including Takāful. They know its importance of the concept. Most Takāful companies have introduced sophisticated products to cater to Takāful sensitive customers. But the marketing side is very important if this segment is to be reached. Marketing should work hard to get non-Muslims to participate in Takāful.⁵²⁰

⁵¹⁷ Ifthikar, Regional Manager, Central Region, Amana Takāful PLC, in the interview held on 07th August 2013.

⁵¹⁸ Ashik, Branch Manager, Kurunegala Branch, Amana Takāful PLC, in the interview held on 26th August 2013.

⁵¹⁹ Mohideen, Former Chairman, Ceylinco Takāful Ltd., in the interview held on 22nd August 2013.

⁵²⁰ Mafahir, Takāful Agent, Amana Takāful, in the interview held on 17th August 2013.

Sharī'ah does not forbid non-Muslims from participating in Takāful or other Islamically based commercial transactions. Mansoor⁵²¹ explains that Islamic law belongs to all mankind and is not exclusively for Muslims. It is up to each individual to accept and implement it if they wish. Indeed, Islamic law provides solutions to all mankind. Muslims must encourage all mankind including non-Muslims to use ethically structured arrangements in business. They should by example that there are Islamic solutions to most current problems. A loan transaction between a non-Muslim and a Muslim is permissible. Prophet Muhammed (PBUH) gave loans to non-Muslims and took loans from non-Muslims. It was also a common practice among the *Sahābahs*. This is also a kind of *Mu'āmalāth*. Helping non-Muslims is also permitted and getting help from them is also allowed. Mihlar⁵²² says that the message of Islam is the message for the international community. As *Ummah al da'wah*, we have to strengthen this concept to give the Islamic message to others, especially to non-Muslims. Furthermore Takāful is an arrangement for the benefit of all human beings. It is a part of *Īmān* when a Muslim desires others to get what he desires to get benefits for himself.

The participation of non-Muslims in Takāful could be for various reasons. They choose Takāful because of the principled motives that guide Takāful. They feel that they can do their work with peace of mind because Takāful is based on brotherhood and self-help, they consider it a place where trust is given its rightful place.⁵²³ There is SSC (Sinhalese Sports Club) for Sinhalese, Tamil Union for Tamils, and Moor's Club for Muslims. But non-Muslims cricketers like to join Moor's Club to avoid alcohol

⁵²¹ Mansoor, Director, *Mishkath* Institute for Islamic Research, Akurana, in the interview held on 16th August, 2013.

⁵²² Mihlar, Head of Social Welfare and Counselling, Zahira College, Colombo, in the interview held on 20th August, 2013.

⁵²³ Atham Bawa, President, Ampara District *Jam'iyyathul 'Ulamā* and Vice-President, All Ceylon *Jam'iyyathul 'Ulamā*, in the interview held on 28th August, 2013.

consumption and spend their time in an ambience of dignified and descent behaviour. There are business ventures which are run jointly by Muslims and non-Muslims which are conducted on Islamic principles. Similarly, they like to have an alternative for conventional insurance for ethical reasons.⁵²⁴ A number of non-Muslims dislike what they too feel are harmful practices i.e. interest, uncertainty, gambling.⁵²⁵ The Takāful concept has the principle of brotherhood, in this system they can get compensation for loss and the premium that is paid will become an investment as well. Fair minded people will accept this as a good system. It must be remembered that this is an ethical system not merely a faith based system. In a multicultural and multi-ethnic country like Sri Lanka, The Takāful initiative is indeed most welcome.⁵²⁶

The Takāful industry must work out strategies to attract non-Muslims. They have to work hard and implement constructive business plans for the above purpose. Murshid Mulaffar⁵²⁷ is confident that if the industry can promote the beauty of the Takāful concept, non-Muslims will join in this process. Nafees⁵²⁸ says that we can propagate the significant elements of Takāful by avoiding the name of Islam, through television, newspapers, seminars, conferences by presenting research papers, (educated people will understand and recommend it for others), conducting seminar for the religious clergy and media personal etc. highlighting the advantages of the Takāful system and emphasising that benefits of this system cover its alternatives. The Takāful message will be well

⁵²⁴ Mihlar, Head of Social Welfare and Counselling, Zahira College, Colombo, in the interview held on 20th August, 2013.

⁵²⁵ Imthiyaz, Legal Officer, Amana Takāful PLC, in the interview held on 24th August 2013 and AM. Mihlar, Head of Social Welfare and Counselling, Zahira College, Colombo, in the interview held on 20th August, 2013.

⁵²⁶ Nafees, Senior Lecturer, Dept. of Islamic Studies, Faculty of Islamic Studies and Arabic Language, South Eastern University of Sri Lanka, in the interview held on 09th July, 2013.

⁵²⁷ Murshid Mulafar, Secretary and in-house Supervisor, *Shari'ah* Supervisory Council, Amana Takāful PLC, in the interview on 19th August 2013.

⁵²⁸ Nafees, Senior Lecturer, Dept. of Islamic Studies, Faculty of Islamic Studies and Arabic Language, South Eastern University of Sri Lanka, in the interview held on 09th July, 2013.

propagated. If we can convince key personal in business, finance and in political administration with the advantages of Takāful, it will be easier to attract non-Muslims.

Meanwhile, Muath⁵²⁹ expresses that as per the government statistics, Muslims are 10% of the population. They cannot attract 90% of people by faith based systems. They can do it by emphasising on value based alternatives. They have to forward our value propositions. They have to explain the concept and create awareness. Meaningful advertisement should be done. TAs per the statistics of the Global Islamic Finance Forum, in 2006/2007 comparing the growth of conventional and Islamic Takāful, the percentage growth was double in Takāful during this period. It shows that not all Takāful customers are Muslims. There is a huge presence of non-Muslims in the Takāful market. When we introduced the concept in Sri Lanka, there were non-Muslims who came from conventional to Takāful. Because of this, there was double digit growth in Takāful operations. We have to maintain this strong awareness and the value based system in Takāful.

4.2.2.5 Staff

The workforce of any company is its biggest asset and a very important element in business development and success in business. Creating a well-rounded approach to managing and coaching the workforce requires the expertise of a human resources leader and the support of the company's executive leadership.

⁵²⁹ Muath, Head of Finance and Corporate Strategy, First Global Group, Colombo, in the interview held on 26th August 2013.

Amana Takāful PLC did not recruit non-Muslims for their managerial positions.

They recently changed this policy. The CEO⁵³⁰ of Amana Takāful says,

A good majority of my sales force are Muslims. According to an independent survey the company did in year 2012, the perception of people in the market is that, Takāful is for the Muslims, by the Muslims, to the Muslims. That is the reality. So, I said let's recruit non-Muslims staff. For example the Pettah branch, does not have anyone other than Muslims in the life segment. Pettah is full of the Tamil traders. We should have to recruit people of that community. Unfortunately, this company has gone on this line for a long time and the time to change. Galle, Matara, Hambantota branches, and even Kalutara, where the Muslims are not more than 2% of population, are all managed by Sinhalese, Buddhists. Jaffna is managed by a Hindu manager. So, Amana Takāful PLC is trying to broad base and loudly say that they have no diversity in their business. So, then they can compete with others with the motto that they are fair to all.

Based on the statement of the CEO, Amana Takāful PLC, has two non-Muslims are their independent non-executive directors. They are Dr. Thirugnana Sambandar Senthilverl and Mr. Radhakrishnan Kopinath. At the same time, ten distinguished non-Muslims are holding managerial level posts in the company. They are ID. Kester Amarasinghe (Assistant General Manager – Technical), NDB. Sakalasooriya (Assistant General Manager – Motor Claims), GHAN. Sooriyaarachchi (Senior Manager – Family Underwriting), R. Thilak Nishantha (Manager – Human Resources), Sumedha Mirihana (Manager – Marketing Activities), S. Jayalath De. Mel (Consultant – Family Takāful), Vasantha Ranasinghe (Consultant – Medical Takāful), Pushpakanthi Gunsekara (Consultant – Technical), UG. Janaka Wijayakumara (Regional Manager – Southern and Sabaragamuwa) and R. Priyanthi Newmen (Manager – Business Development and Group Life).⁵³¹

This is a good move of Amana Takāful PLC. It will benefit the Takāful industry in Sri Lanka and they themselves will be propagandists of the concept. As a result, the

⁵³⁰ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

⁵³¹ Annual Report, 2013, Amana Takāful PLC, pp. 15, 20-23

Takāful concept and its practice will be more acceptable to non-Muslims in Sri Lanka. Takaful will also develop the brand image as a system of insurance for all Sri Lankans.

4.2.2.6 Branches

When Amana Takāful started their operations, there was not a single branch. The first office of Amana Takāful was established in Colombo. Then they opened a branch in Gampola, then in Matale and Kurunegala. In 2002 there were 18 branches, in 2014 there were 24 branches. Now they have 28 branches all over the island. Maldives Amana Takāful is a separate company. Earlier it was one of their branches. Now they are operating separately under the Maldivian license and it is a subsidiary company of Amana Takāful.⁵³²

The following picture shows the places of branches (Amana Takāful PLC) in Sri Lanka and their distribution in 2014.

⁵³²Zaid Aboobucker, General Manager/Operation and Medical, Amana *Takāful* PLC, in the interview held on 19th August 2013.

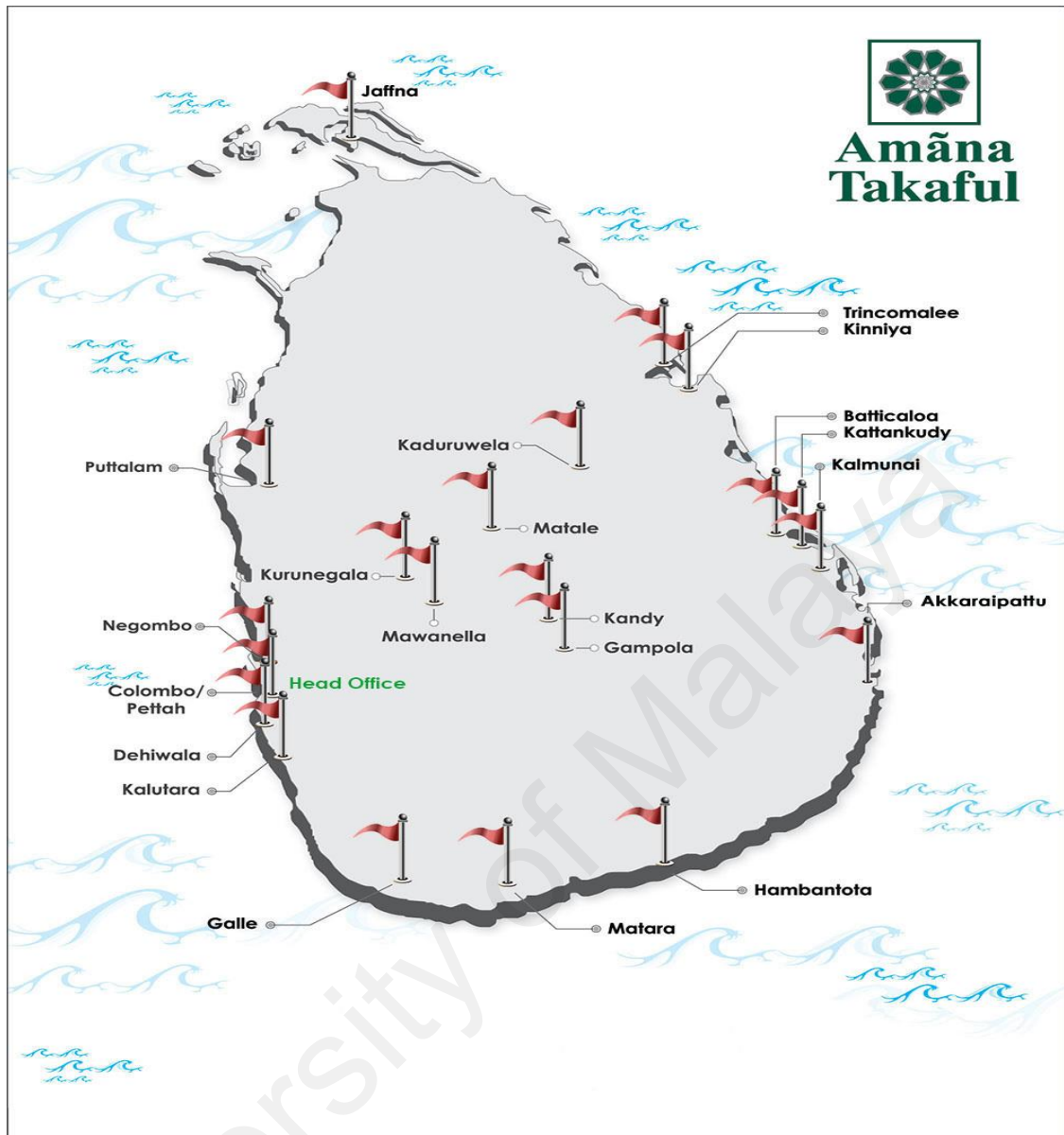


Figure 4.10: Branches of Amana Takāful PLC

Source: Amana Takāful Website

According to CEO⁵³³ of Amana Takāful PLC, they try to go to Sinhalese dominated areas and establish their branches there. They can take advantage of Sinhala language proficiency of Muslims to use it for this purpose. There are Sinhala language skilled people among the members of the hospitalisation *Shari'ah* Supervisory Council.

⁵³³ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

According to Ashik,⁵³⁴ Kurunegala Branch Manager of Amana Takāful PLC, the Kurunegala branch was established in 2002. It is established in a central location because the political decentralisation programme in the country is underway. Their idea is to make the Kurunegala branch a hub for the north central region. The main five conventional insurers including Janashakthi, Sri Lanka Insurance, Ceylinco are operating their regional office in Kurunegala. They have to upgrade their facilities to compete with them. By uplifting the facilities, they can provide greater customer satisfaction.

4.2.2.7 Retakāful

Retakāful is a challenge for Amana Takāful PLC. Most of its retakāful business is out sourced. They have some retakāful advisors and agents in Malaysia. Through them they operate worldwide. They also have some retakāful contacts now in India as well as in the Middle East. Another difficulty they encounter in retakāful is the *Shari'ah* factor.⁵³⁵

Amana Takāful PLC has a good panel of retakāful operators. MNRB Retakāful Berhad (MRT) is registered by BNM as the first retakāful operator in Malaysia in 2007. MRT is involved in the family and general retakāful businesses. The GIC Takāful reinsurance is India's only reinsurer providing reinsurance based on *Shari'ah* principles. Labuan Re was incorporated in the international offshore financial centre of Labuan (an island off the south-west coast of Sabah, a state in East Malaysia) in 1992. The company was established as an international reinsurer and has over a short period of time become a major player in the Afro-Asian insurance/reinsurance industry. Trust International Bahrain provides reinsurance protection to many leading direct insurance companies in

⁵³⁴Ashik, Branch Manager, Kurunegala Branch, Amana Takāful PLC, in the interview held on 26th August 2013.

⁵³⁵Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

the geographical area of operation, in the form of annual treaties on proportional and non-proportional basis with a sizable underwriting capacity. Catlin Labuan Ltd. (Lloyds Syndicate) is a specialist property/casualty reinsurer writing more than 30 classes of business worldwide. And Hannover Re, with gross premium of around EUR 14.0 billion, is the third largest reinsurer in the world. It transacts all lines of property/casualty and life/health reinsurance and is present in all continents with around 2,400 staff.

Hifly Huzair⁵³⁶ Manager, HNB Assurance Takāful says that although HNB Assurance is a conventional insurer, they have already connections with retakāful companies like Munich Re, Labuan Re. It is a statutory requirement for all insurers that a certain percentage of the portfolio should go for reinsurance or retakāful.

In terms of the standards for retakāful, Amana Takāful follows AAOIFI standards.

Murshid Mulaffar⁵³⁷ says,

Amana Takāful PLC follows 100% AAOIFI standards for retakāful. Where Islamic avenues are available, they retakāful only in those places. Sometimes, a high value asset like an aircraft or a ship can cause capacity constraints with the existing retakāful companies not being in a position to cover it. In such a situation, AAOIFI permits reinsurance with even conventional reinsurance companies. Amana Takāful also uses this regulation and utilises more than 90% of funds in retakāful companies.

4.2.2.8 Bancatakāful

The most rapidly expanding sector of the worldwide bancassurance industry – distributing insurance products via banks – is bancatakāful. This applies the

⁵³⁶Hifly Huzair, Manager, HNB Assurance Takāful, in the interview held on 24th August 2013.

⁵³⁷Murshid Mulaffar, M., Secretary and in-house Supervisor, *Sharī'ah* Supervisory Council, Amana Takāful PLC, in the interview on 19th August 2013.

bancassurance model to Takāful, a *Shari'ah* compliant mutual and cooperative system of reimbursement, where members contribute money into a pooling system in order to guarantee each other against loss or damage.⁵³⁸

As more Takāful companies offer a fuller range of retail family-oriented products into the market, they tend to find banks to be the best distribution channel. Bancatakāful (the Islamic equivalent of bancassurance) provides an attractive, cost effective, and increasingly prevalent way of selling Takāful products. Banks have the opportunity to leverage their networks to distribute Takāful and generate cross-selling opportunities by bundling and are also well placed to achieve valuable economies of scale in marketing, IT and back-office processes, as well as generating sales leads via call centres, branch networks and personal bankers. The potential for those efficiency gains is especially strong in the more densely populated countries where Islamic finance is starting to take off.⁵³⁹

Amana Takāful PLC is involved in bancatakāful activities. They are tied with leading banks including Seylan bank, Commercial bank, Sampath bank and their own Amana bank. They are trying to move into Bank of Ceylon and already have ties with Bank of Ceylon in *Ijārah* operations.⁵⁴⁰

⁵³⁸ Jaffer, S., Emergence of Bancatakāful Worldwide, World Commerce Review, retrieved through http://www.worldcommercereview.com/publications/article_pdf/804_on_11th_December_2015, p. 1

⁵³⁹ *Ibid.*, p. 5

⁵⁴⁰ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

4.2.2.9 Education, Training, and Research

The Takāful industry needs continuous education, training, and research to develop. In this regard, Amana Takāful has taken a lot of measures to increase sales and inculcate professionalism through training and skills development efforts. Every Friday they have a specific training period for one hour in the morning. They make the staff develop their selling skills, all part of sales and the product knowledge. Through that they explain to staff techniques to convince customers of the benefits, explain the features of Amana Takāful products, and they improve progressively through this weekly training.⁵⁴¹

Takāful is also included in the curriculum of the IBSL which conducts Diploma courses in Banking & Finance. And Amana Takāful PLC also gives *Sharī'ah* training to the staff region wise. The *Sharī'ah* board conducts this training and in case a customer query could not be responded as the officer did not know the answer, he can call the *Sharī'ah* board and clarify the matter. Once in six months, they have a *Shari'ah* training programme.

4.2.2.10 CSR Programmes

Community is the base for any company including Amāna Takāful. Therefore, they give priority to community related programmes. After nearly 10 years of operations in Sri Lanka, a managerial decision was taken by Amana Takāful to streamline and formalise their Corporate Social Responsibility (CSR) activities under the banner, “Amāna Takāful Cares”.

⁵⁴¹ Ifthikar, N.M., Regional Manager, Central Region, Amana Takāful PLC, in the interview held on 07th August 2013.

Amāna Takāful Cares focuses its activities on health care, education and children. With these concerns as guideposts the following programmes were developed, in the hope of uplifting the lives of the less fortunate in rural areas by enhancing the educational standards of children in rural areas, guiding street children towards education, developing of health care facilities in rural areas and economic assistance to the less fortunate.

Their CSR programmes each bear the hallmarks of the Takāful concept. They partner with local organisations and charities which are located close to their branch sites in order to facilitate coordination and monitoring, for the most effective utilisation of proceeds. Further they attempt to utilise the funds mobilised by a branch to benefit the communities within that area. This leads to a truly community based approach to social responsibility.⁵⁴²

Sometimes they distribute gift items. When they open a new branch, they distribute these compliments among customers. Sometimes they give them to non-customers also. Recently when they opened a new branch, they handed over a wheel chair to a person who was not their customer. Similarly, they gave sports goods to a school which were handed over to the principal of the respective school and to two parents of the same school. These are welfare services of Amana Takāful. They have done some other community services as mentioned earlier.⁵⁴³ They offer compliments like mugs, umbrellas, school bags, toys for nursery children etc.⁵⁴⁴

⁵⁴² <https://www.takaful.lk/about/csr.php> retrieved on 11th October 2014

⁵⁴³ Mahroof, Sales Executive, Amana Takāful, Kurunegala Branch, in the interview on 26th August 2013.

⁵⁴⁴ Mafahir, Takāful Agent, Amana Takāful, in the interview on 17th August 2013.

4.2.2.11 Takāful Window

A very important development of Takāful industry of Sri Lanka is the commencement of Takāful windows by conventional insurance players. HNB Assurance Takāful is the first window of this kind in Sri Lanka. They have opened non-life Takāful and life Takāful under HNB Assurance.

Murshid Mulaffar⁵⁴⁵ appreciates this new development saying,

The big development, we see in the Takāful industry, after completion of ten years, is that the other financial institutions have come forward to start Takāful windows. LOLC which is a big leasing operator will start a Takāful window very soon. Sometimes the Takāful windows may pose some *Sharī'ah* issues in practice. For instance: The government and the regulator consider HNB Assurance and HNB Assurance Takāful as one company. When they are required to invest in treasury bills, they can use conventional insurance money to cover it and they can invest 100% of Takāful money in the avenues that are permitted in Islam. In this way they can minimise the downside of this problem. Further, if other companies open Takāful windows and run it sophisticatedly, it is easy to talk with the government to get separate regulatory provisions for the Takāful industry.

4.3 Conclusion

There are very clear developments in the Sri Lankan Takāful industry. In terms of jurisprudential developments, the existing Takāful companies and the company which is prohibited to engage in Takāful activities exerted efforts to activate a suitable model for the Sri Lankan market. They examined the *Muḍārabah* model first and then the pure *Wakālah* model. They are now practicing now Pure *Wakālah*, *Waqf* and *Wakālah-Waqf* models differently. But there is a need to carry out a study on the appropriate model for

⁵⁴⁵Murshid Mulaffar, Secretary and in-house Supervisor, *Sharī'ah* Supervisory Council, Amana Takāful PLC, in the interview on 19th August 2013.

the Sri Lankan Takāful industry. In terms of Takāful standards they unanimously agree to implement AAOIFI standards.

The second part of this chapter dealt with business developments of the Sri Lankan Takāful industry. The business developments were analysed under 11 sub titles namely growth, products, investments, participants, staff, branches, retakāful, bancatakāful, education, training and research, CSR programmes, and Takāful window. There are notable developments in every area of these activities.

Finally, the future prospects of the Takāful industry in Sri Lanka will be very much dependent on the collective efforts of all related parties; the government authorities, market practitioners, *Shari'ah* scholars, customers and the international technical and consultancy support.

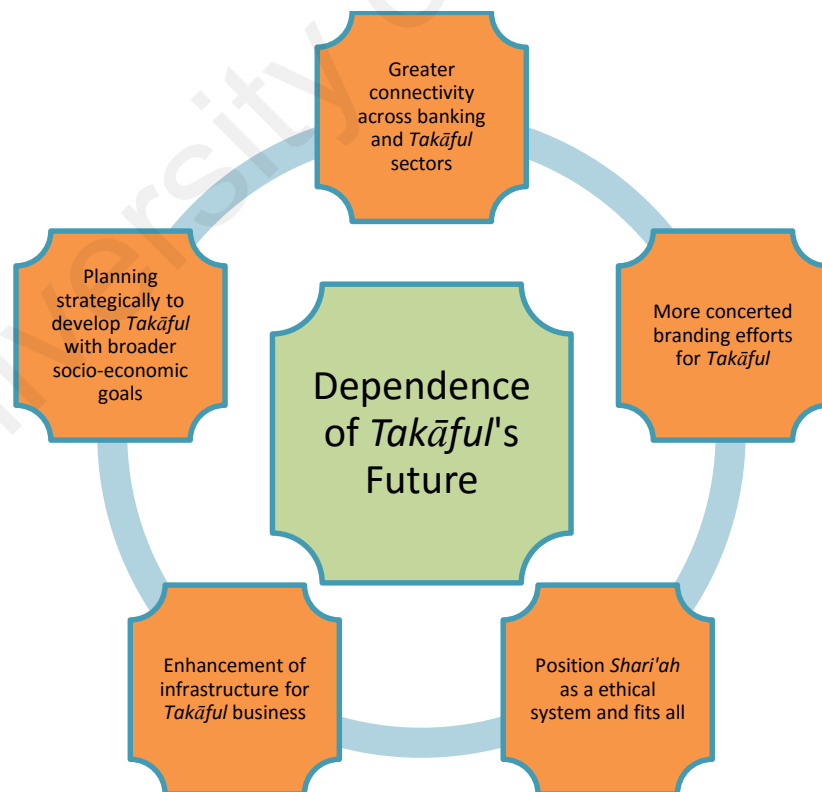


Figure 4.11: Dependence of Takāful 's Future

CHAPTER 5: CHALLENGES OF TAKĀFUL IN SRI LANKA

5.1 Introduction

The basic structure of a *Shari'ah* compliant insurance system has been generally accepted by the *Shari'ah* scholars to be essentially based on the principle of mutual help by group members. The way ahead is to improve/reform and develop the existing operational structures in respect of the models and procedures. A number of conceptual issues need to be addressed to ensure credibility and thus enhance the acceptability of the new industry. Other problems that have to be addressed are adequate capitalisation, enabling Takāful operators to work in competition with the conventional companies, developing human resources, retakāful facilities and *Shari'ah* compliant avenues for investment of funds, standardisation/harmonisation of the practices and providing legal and regulatory frameworks for healthy operation of the industry.

The following figure summarises the core challenges of Sri Lankan Takāful industry.



Chart 5.1: Challenges of Takāful Industry in Sri Lanka

Source: Based on the data collected through the interview

5.2 Lack of Public Awareness

Despite the introduction of Takāful, the increase in the level of penetration anticipated has yet to be realised. Lack of awareness on insurance particularly on Takāful is a big hindrance in development process of Takāful industry.

From a customer perspective, there are many people are still unaware of Takāful as an alternative to conventional insurance. Some view Takāful as commercialisation of conventional insurance into the Islamic world and reject the notion that it is a *Shari'ah* compliant system. In addition, many individuals tend to downplay the importance of security and retirement planning and many are also heavily dependent on the social

security systems like *Bait al Māl*, *Bait al Zakāh* and *Waqf*.⁵⁴⁶ Similar to conventional insurance, Takāful coverage is typically a proposition that needs to be sold to consumers (instead of one that is bought by consumers). There is a need to fundamentally address educational issues surrounding Takāful and individual risk management among the Muslim society in Sri Lanka, to develop customer awareness. Most of the current education on Takāful is aimed at interested or related practitioners and investors, and very few awareness campaigns are aimed at or designed for the target population.

In this regard Zaid Aboobucker says,

Earlier, the Muslims did not involve in insurance as well as in Takāful except third party insurance as it was a compulsory requirement of the government. When we explained to people the concept that the premium contribution is in the nature of *tabarru'* and what it means in practice is that when the risk of loss happens to any of our members, the participating group gives compensation to him. But they did not understand these terms, conditions, policy concepts. Even who understood the concept of insurance did not understand this new system.⁵⁴⁷

The key challenge that the Takāful industry of Sri Lanka is facing, is creating awareness about the Takāful concept itself. The majority of the Muslim population avoid insurance including Takāful due to incorrect understanding of some religious concepts. They think that Takāful is inconsistent the *Qaḍā' wa al Qadr* and *Tawakkul* concepts of Islam.⁵⁴⁸ They need to be assured that taking out cover against catastrophes in a manner conforming to the principles of *Sharī'ah* does not involve any prohibitions.

In this regard, *Sharī'ah* compliance reports by the *Sharī'ah* board or by a *Sharī'ah* advisor and periodic *Sharī'ah* audit are required for every Takāful company, not only for

⁵⁴⁶ Some people who are of the view that *Bait al Māl*, *Bait al Zakāh* and *Waqf* can do what the Takāful companies do, even though these social welfare institutions are not in a satisfactory state in Sri Lanka in terms of organisational capabilities, services rendered, coverage and conceptual framework.

⁵⁴⁷ Zaid Aboobucker, General Manager/Operation and Medical, Amana Takāful PLC, in the interview held on 19th August 2013.

⁵⁴⁸ Mafahir, M.M.M., Takāful Agent, Amana Takāful, in the interview held on 17th August 2013.

ensuring *Sharī'ah* compliance but also for enhancing the knowledge pool of Takāful of the public with regard to *Sharī'ah* -related issues. Fazal Ghaffoor,⁵⁴⁹ CEO/Amana Takāful PLC reveals that principally many people in the Muslim community wonder whether insurance is *ḥalāl* or *ḥarām*. That is why *Sharī'ah* scholars can provide a yeomen survey with their skills and with their knowledge, powers and persuasion to tell people it is a choice, but this choice is lawful.

Ashik⁵⁵⁰ accepts that awareness issue is strongly present. He further says that he concerns of the Muslim community have to be addressed, because their knowledge of insurance is shallow. Until now, he says that they did not face any problem from a non-Muslim customer. Muslim customers are generally unaware about what insurance is? They think if they got a policy, total loss has to be paid to them. They do not know about valuation, IBSL rules, claim regulations, etc. Sometime, even if they know they pretend that they do not know. It is a big challenge to promote Takāful among Muslims. Their opinions spread by word of mouth can be very dangerous.⁵⁵¹

The Takāful awareness is very low among the Muslim customers and so is their knowledge of normal insurance. Takāful operators make earnest efforts to increase this awareness, but only around 80% of the problem has so far been addressed. They have provided the knowledge only to 15-20% of Muslims.

Mafahir⁵⁵² reveals the practical side of the problem stating that Takāful is a good concept. But people do not understand this concept fully. If they understand this system

⁵⁴⁹ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

⁵⁵⁰ Ashik, M.M.M., Branch Manager, Kurunegala Branch, Amana Takāful PLC, in the interview held on 26th August 2013.

⁵⁵¹ Mohideen, S.A.H., Former Chairman, Ceylinco Takāful Ltd., in the interview held on 22nd August 2013.

⁵⁵² Mafahir, M.M.M., Takāful Agent, Amana Takāful, in the interview held on 17th August 2013.

thoroughly, its benefit will cover all people. When the company launches a new product, it expects several thousand people to use that product. If the expected client numbers are exceeded, then the company can reduce the price as the average cost in this project reduces.

It is hard to introduce the insurance to the people because of the matter of low awareness. Takāful is also about future protection of an event that may occur in future or may not occur. The Takāful operator or agent normally explains the positive side of the policy i.e. benefits. At the time of selling the policy, proposal has been signed and confirmed, and when the policyholder makes a claim, a plethora of problems start. Because of the policyholder did not understand most matters which the introducer told him. He⁵⁵³ further says that in the marketing segment, all agents/brokers not on the same wavelength. An agent's target may be to maximise earnings through introducing many policies. He may or may not explain to the customer all the advantages of the policy. In this regard, the company also has to hold responsibility to clarify/examine and explain to the policyholder at least the crucial issues when he comes to participate in a policy.

In the *Sharī'ah* scholars' perspective, the lack of awareness is not limited to common people in the Muslim community. It is also widespread among many religious scholars. Mubarak⁵⁵⁴ explains that in Sri Lanka, the first major challenge the Takāful initiatives faced was from '*Ulamas*. They said that Takāful is just another label of conventional insurance. The *Sharī'ah* Supervisory Council members went to some areas to educate religious scholars about this system. The '*Ulamas* said, "You are talking new things, which we do not understand". Then, the council members explained them

⁵⁵³ Mafahir, M.M.M., Takāful Agent, Amana Takāful, in the interview held on 17th August 2013.

⁵⁵⁴ Mubarak, M.M.A. Chairman and Murshid Mulaffar, M., Secretary and in-house Supervisor, Sharī'ah Supervisory Council, Amana Takāful PLC, in the interview held on 19th August 2013.

that this system exists in Islam in various forms citing the story of Yusuf (A.S.) and other relevant references.

Rahman⁵⁵⁵ talks about another issue with regard to the Islamic financial instruments in Sri Lanka. There are some Islamic groups which are working to educate people somewhat negatively about the Islamic doctrines and teachings. One of these groups, the *Tawhīd Jamā'at* is against the operating modalities of both Takāful and Islamic banking. They incorrectly hold the view that because of the registration of these entities with the Central Bank of Sri Lanka or the Insurance Board the regulatory framework is hostile to *Sharī'ah*. It must be noted however that Takāful or Islamic banking industry does not invest in interest based instruments available at the central bank. Muslims cannot undertake any form of institutionalised financial undertaking without registration in the regulatory body. This is the law of the land.

The Takāful industry in Sri Lanka is mostly geared to providing general business policies. The real business potential however lies in family Takāful or Takāful *Ta'āwani*, to realise this, practitioners need to mobilise business in the larger theatre of general public in Sri Lanka. For this they also need a sound financial basis. Composite business has the benefit of offering annual products, which are expense and surplus driven, allowing an early and much needed cash flow for successful Takāful business. Family Takāful programmes, on the other hand, are cash-absorbing businesses in the early years of establishment of the company. This problem can be solved only by enhancing the capital base of the companies, which, of course, would benefit them in subsequent years.

⁵⁵⁵ Rahman, S.M.M., Branch Manager/Life, Kalmunai Branch, Amana Takāful PLC, in the interview held on 11th July 2013.

Zaid Aboobucker⁵⁵⁶ says,

We have done lots of awareness programmes for *Sharī'ah* scholars in so many places like Weligama, Akurana, Kattankudy and Kandy. Overall publicity for public and for scholars, I think we have done, but perhaps not enough when compare to other companies. We do not have enough strength for that. It has a cost. We have a 2% plus share of market in the industry. But we can see positive developments. We have to spread family Takāful business a little bit more.

Mihlar⁵⁵⁷ analyses the reasons of the lack of awareness expressing as we are living as a minority in Sri Lanka where the awareness of Islamic banking is limited. These subjects are not taught in Arabic colleges, when the *‘Ālims* do not have enough understanding on the subject, then society does not get enough knowledge inputs from them, the result is that clients remain ignorant of the benefits of Takāful. I think the major challenge is a sequences of shortcomings in knowledge based industry. If we can eliminate this ignorance, it will help us to abolish the spiritual decadence. For instance, the suspicion surrounding the concepts, doubts about its survival, questions about its relevance to society. Some wonder why they have to pay more to get a policy from Takāful when it can be obtained at lower price in the conventional market? Takāful companies have less number of clients. Consequently, the price will be high. The conventional insurers have more clients and they can give the policy at a lower price or more facilities or attractive bonuses.

5.3 Lack of Expertise and Trained Staff

Providing well-trained and competent manpower for the nascent Takāful industry is another challenge. Only committed, trained and experienced personnel can enhance the

⁵⁵⁶ Zaid Aboobucker, General Manager/Operation and Medical, Amana Takāful PLC, in the interview held on 19th August 2013.

⁵⁵⁷ Mihlar, A.M., Head of Social Welfare and Counselling, Zahira College, Colombo, in the interview held on 20th August, 2013.

acceptability of the system among the public. There are mainly two types of workforce in practice. One is recruited employees of Takāful companies including CEO, product managers, branch managers, working staff, sales representatives and Takāful agents. Another one is employment of *Sharī'ah* advisory council members who are outsiders of the company who work for the company as advisory and in-house supervisors in terms of *Sharī'ah* auditing requirements.

5.3.1 Takāful Officers/Employees

Future growth may also be hampered by the current narrow pool of professionals with sufficient Takāful knowledge in areas such as law sales and actuarial services. Most operators would typically employ human resources, such as legal advisors and actuaries, with conventional insurance experience. These resources would typically tend to learn the *Sharī'ah* aspects of Takāful and adapt their previous experience to incorporate *Sharī'ah* compliance rules in their new role. Hence the mindset of most operators tends to be driven by conventional thoughts and solutions and, as a result, there has been limited original thinking in the industry.

Fazal Ghaffoor⁵⁵⁸ explains the practical problems of this regard,

The best of our underwriting expertise have been brought over in the Middle East by paying a high salaries and other facilities. So, the industry is all the time recruiting and training but people are being poached from here because we are the only Takāful operator. Therefore, it is something we have to always start replenishing. But I am quite happy that we are nursery. These boys go back to the Middle East for four, five years and earn some money, come back to Sri Lanka and join us. It is a cycle”.

⁵⁵⁸ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

At the same time, Mubarak⁵⁵⁹ holds the opinion that the persons who have professional qualifications in accounts or management can work as Takāful employees. They do not need to know anything about Takāful at the point of recruitment. They are not subject oriented people. Murshid Mulaffar⁵⁶⁰ is also of the same perception. While there are some facilities locally available for training in Islamic banking, facilities in respect of Takāful are almost entirely lacking.

Mafahir⁵⁶¹ also says that people working in Takāful are not there continuously because of the low salary prevailing in the industry. They have to supplement their income by depending on the commission they get from the business. If the industry recruits 10 people, one or two persons remain after two months. This also affects customer care. And the company recruits persons who worked at other conventional companies giving some good offers. The people who work continuously in the company do not get motivation, salary increment etc. one person works a long period in Amana Takāful as sales executive, another person will be recruited from another company as sales executive, Later one gets double salary than the first person. Therefore, the person who works a long period for the company will be frustrated. He will not work happily.

Mohideen⁵⁶² reveals the actual situation and the reason for it stating that the technical side of conventional insurance has enough people. There are trainers, and many follow conventional courses all this time; there are exams for all technical aspects of conventional insurance. *Sharī'ah* compliant Takāful is still not in the same league, not education and training wise. The important thing is it to have a professional institution to

⁵⁵⁹ Mubarak, M.M.A., Chairman and M. Murshid Mulaffar, Secretary and in-house Supervisor, *Sharī'ah* Supervisory Council, Amana Takāful PLC, in the interview held on 19th August 2013.

⁵⁶⁰ Murshid Mulaffar, M., Secretary and in-house Supervisor, *Sharī'ah* Supervisory Council, Amana Takāful PLC, in the interview held on 19th August 2013.

⁵⁶¹ Mafahir, M.M.M., Takāful Agent, Amana Takāful, in the interview held on 17th August 2013.

⁵⁶² Mohideen, S.A.H., Former Chairman, Ceylinco Takāful Ltd., in the interview held on 22nd August 2013.

disseminate Takāful education in an organised manner. Takāful education is very weak and poor in quality.

In addition, Mahroof⁵⁶³ says that there is lack of Islamic values among the officers, especially Takāful agents / brokers. They should demonstrate empathy, be social minded, helpful and caring to customers. They should be trained under the guidance of top management.

Even though there are problems in procuring technically skilled expertise into Takāful industry, Amana Takāful PLC has taken some measures to train the people. According to Rahman,⁵⁶⁴ the company gives *Sharī'ah* training to staff region wise. The *Sharī'ah* board does this training and in cases where a customer has a question, and the officer did not know the answer; arrangements exist to call the *Sharī'ah* board and clarify the matter. Once in six months, we have *Sharī'ah* programme. Several employees who came from conventional companies, are trained on the basis of *Sharī'ah* and are taught how to differentiate Takāful from non-Takāful concepts and practices.

5.3.2 *Sharī'ah* Scholars

The Takāful system was established based on the framework of *Sharī'ah* principles. Therefore, it is necessary to ensure that the Takāful system develops and operates under the framework of *Sharī'ah*. Hence, the *Sharī'ah* supervisory board (SSB)

⁵⁶³ Mahroof, A.J.M., Sales Executive, Amana Takāful PLC, Kurunegala, in the interview held on 26th August 2013.

⁵⁶⁴ Rahman, S.M.M., Branch Manager/Life, Kalmunai Branch, Amana Takāful PLC, in the interview held on 11th July 2013.

is set up to monitor the operation of the company. If it deviates from the *Sharī'ah*, the board will advise and guide the company accordingly.

The SSB, as an important board in a Takāful company, plays major roles in ensuring that the objectives of the establishment of the company are met. The roles and functions of the board can be divided into two: monitoring the operational side of the company itself and monitoring the investment side run by the company. It may have one more as an indirect function, and that is to provide the service to the public.⁵⁶⁵ The SSB consists of a number of *Sharī'ah* scholars who conduct internal *Sharī'ah* audit of Islamic financial Institutions and are required to approve the *Sharī'ah* compliance of new financial products before they are launched commercially. In summary, the Islamic financial institutions are controlled by Board of Directors (BoD) on financial matters and the *Sharī'ah* Supervisory Board (SSB) to ensure their compliance with *Sharī'ah*.⁵⁶⁶

The AAOIFI has prepared a standard for a *Sharī'ah* supervisory board, its composition and related aspects like rulings, report, etc. According to this standard, a *Sharī'ah* board should be an independent body of specialised jurists in Islamic commercial jurisprudence. It may also include other experts in areas of Islamic financial institutions with knowledge of Islamic jurisprudence relating to commercial transactions.

In Pakistan, Securities and Exchange Commission of Pakistan (SECP), the regulator passed the following rules regarding the *Sharī'ah* Board (2012).

⁵⁶⁵Ma'sum Billah, Roles of the *Sharī'ah* Supervisory Board, retrieved through http://www.takaful.coop/index.php?option=com_content&view=article&id=77&Itemid=61 on 29 October 2012, p.1

⁵⁶⁶Garas, S.N. (2012) The Conflicts of Interest inside the *Sharī'ah* Supervisory Board, International Journal of Islamic and Middle Eastern Finance and Management, vol.5, No. 2, Emerald, pp. 88 and 89

1. The Commission may establish a *Sharī'ah* Advisory Board consisting of such number of members as may be decided by the Commission.
2. The *Sharī'ah* Advisory Board will be responsible to formulate policies and guidelines for operation and management of Takāful business in line with *Sharī'ah* principles.
3. If in the opinion of the Commission different treatment for a similar operational issue is adopted by various operators, with the approval of their *Sharī'ah* Advisor, the matter shall be resolved by the *Sharī'ah* Advisory Board and the findings of the *Sharī'ah* Advisory Board shall be final.
4. The Commission may assign any other responsibility to the *Sharī'ah* Advisory Board from time to time.
5. The minimum qualification and experience of the *Sharī'ah* Advisor of the Takāful operators / window Takāful operators shall be as follows:
 - (a) Educational Qualification:

Shahādat ul 'Aalamia Degree (*Dars e Nizami*) from *Madaris* recognised by the Higher Education Commission of Pakistan with a certificate in *Takhasuş fil Iftā / Takhasuş fil Fiqh* and adequate knowledge of Islamic finance and Takāful.
 - (b) Experience and Exposure:

Must have at least 4 year experience of giving *Sharī'ah* rulings including the period of *Takhasuş fil Iftā* or *Takhasuş fil fiqh* and must also have sufficient command over English language and applicable Pakistani laws.
6. A person cannot work as *Sharī'ah* Advisor at a time for more than three operators in Pakistan.⁵⁶⁷

⁵⁶⁷ Securities and Exchange Commission of Pakistan (SECP), Takāful Rules 2012, Part V Compliance with Principles Of *Sharī'ah*, pp. 15, 16

In terms of *Sharī'ah* expertise in the field of Takāful in Sri Lanka, it is another big challenge facing the Takāful industry. Every Takāful operator mandatorily requires a *Sharī'ah* supervisory board, which is typically comprised of three or more *Sharī'ah* scholars. For a Takāful operator with regional ambitions, the need to build credibility in the target market means there are preferences for the board members to originate from the target markets or at least have experience in the target market. Scholars would ideally have experience and knowledge not only in jurisprudence but also in Takāful. This is essential as board members are responsible for certifying the *Sharī'ah* compliance of the business operations. However, the number of *Sharī'ah* scholars with experience in both Islamic jurisprudence and insurance is limited. Inevitably, these scholars are sitting on multiple boards, which may create conflicts of interest and compromise the quality of advice. The shortage in scholars remains a short-term barrier on new entrants and drives up the cost of setting up a *Sharī'ah* board.

The *Shari'ah* governance of the Islamic financial industry in Sri Lanka is inadequate in term of competency and efficiency. *Sharī'ah* board consists some foreign scholars who are very busy and member of several international institutions all over the world, like *As Sheikh* Taqi Usmani of Pakistan is a classic example. The *Sharī'ah* boards do not consist of any PhD holders or intellectuals and learned persons who have very clear knowledge on *Fiqh al Mu'āmalāt* and *Uṣūl al Fiqh* in their respective bodies as full time *Sharī'ah* advisors.

In this regard, Mansoor⁵⁶⁸ says that Takāful concepts are not in old *fiqh* books. So, surely, the '*Ulamas* who represent the *Sharī'ah* council should come out of traditional

⁵⁶⁸ Mansoor, M.A.M., Director, Mishkath Institute for Islamic Research, Akurana, in the interview held on 16th August, 2013.

fiqh. There is for example a separate research on *Mudārabah* in International Institute for Islamic Thought (IIT) group. The research is about how to implement the *Mudārabah* system successfully. The *Sharī'ah* council members should read and understand this type of research work. They also have to possess knowledge of all *Madhhabs* (Jurisprudential Schools of Thought). But in the practice, these institutions try to get its reputation quickly. Therefore, they appoint reputed and popularly known '*Ālim* to *Sharī'ah* council. It should not be like that. The company should have a long term plan. It will get its reputation gradually by the quality and *Sharī'ah* compliant work it does. This cannot be achieved through fame of some individuals. And he⁵⁶⁹ further says lack of training in both ways technical knowledge and spiritual ambience for the operators, managers and agents is another challenge. For instance: In Sudan, when the son of King Faisal decided to start Faisal bank, first he took steps to offer one year training for the officers. After that the company started. If the both aspects of training were are properly incucated, the officers will work with fear of *Allah*. I think the spiritual training is very weak here.

Mihlar⁵⁷⁰ states that the company should maintain international standards to get recognition or acceptance among people. To maintain international standards, the *Sharī'ah* scholars should have professional training and certification. It should not be a case of the blind leading the blind as I observe is the situation of the Islamic finance industry in Sri Lanka. Most of the scholars do not know that they do not know. There is possibility to think that if they get a qualified scholar, he may be a serious researcher or University lecturer or professor, but he may not has enough clients, industry acceptance. We observe in foreign countries that there is a limitation on the number of institutions

⁵⁶⁹ Mansoor, M.A.M., Director, Mishkath Institute for Islamic Research, Akurana, in the interview held on 16th August, 2013.

⁵⁷⁰ Mihlar, A.M., Head of Social Welfare and Counselling, Zahira College, Colombo, in the interview held on 20th August, 2013.

that a scholar can serve. They can be *Sharī'ah* advisors for two institutions or three institutions at the most, if they take on more they will not have time to involve in more quality work. Those who are in the *Sharī'ah* board should realise the limitations in their level of understanding of complex commercial matters. They may not have even got through the General Certificate of Education (G.C.E.) Ordinary Level (O/L) or Advanced Level (A/L), while they serve as *Sharī'ah* Scholars. This is a great loss and danger to society and is not a healthy sign. In foreign countries, we observe scholars such as Hussain Hāmid Hassān who is a very senior. Today even seniors in the industry, PhD holders, and post-doctoral scholars are compelled to work hard to survive in institutions although they have understood complex business trends, its terminologies in the emerging business environment.

He⁵⁷¹ further says that there is a trend that appointing a *Sharī'ah* board member as customary practice. They do not appoint a *Sharī'ah* scholar properly paying money, but they appoint him as an external body, consult him once a month or once in three months or he will be an in-house officer merely for name sake. When the branches increase, he cannot do all works alone. In this situation, the officers who work there, they do the role of *Sharī'ah* advisor. Indeed the *Sharī'ah* advisor should audit each and every paper and get satisfied with *Sharī'ah* compliance. In the future, the steps should be taken to develop *Sharī'ah* scholars as like as to develop the business.

The shortage of *Sharī'ah* scholars in the field of Takāful might create conflicts of interest when the SSB member sits on several SSBs and takes advantage of the information of the IFIs. The number of qualified *Sharī'ah* scholars is too limited to meet

⁵⁷¹ Mihlar, A.M., Head of Social Welfare and Counselling, Zahira College, Colombo, in the interview held on 20th August, 2013.

the growing demand of the IFIs. However, Bakr⁵⁷² argues that the involvement of *Sharī'ah* scholars in more than one SSB leads to conflicts of interest because it is hard to express an independent opinion for two different IFIs during the release of new products by two competitors. On the other hand, the IFIs' regulators did not issue a standard or address the consequences of violating the privacy rules and sharing the information of one IFI with one another. However, the existence of a code of ethics inside the IFIs can work as a supplementary document that informs the SSB members about the rules of privacy and information sharing. The discussion is theoretically sound; nevertheless, it is hard to be applied practically because the IFIs are obliged to choose from the available *Sharī'ah* scholars.⁵⁷³ Some of the IFIs (*Khaleeji Commercial Bank* in Bahrain, *Dubai Islamic Bank* in Dubai, and *Qatar Islamic Bank* in Qatar) have recruited popular *Sharī'ah* scholars who are multi-lingual with advanced knowledge in economy and law in order to have a relative advantage in the market.

However, sitting on several SSBs will enable the SSB member to have access to a lot of crucial information such as new products and services, managerial violations inside or outside the operation which might lead to potential losses, and the performance of the current projects and products.⁵⁷⁴ This information can bring tangible or intangible benefits to the SSB member such as moving the investments from one institution to another in case of potential losses and sharing the information of one institution with its competitors, clients or other stakeholders. Hence, the AAOIFI Governance Standard⁵⁷⁵ recommends recruiting an expert in the field of Islamic finance with normal knowledge

⁵⁷² Bakr, M. (2002), "The independence of *Sharī'ah* advisors in the framework of *Sharī'ah* supervision functions and duties", Proceedings of Second Annual Conference of AAOIFI, Bahrain, pp. 1-24.

⁵⁷³ Al Qari, M. (2008), "Conflicts of interest", Proceedings of a Seminar about the Future of Islamic Banking by National Commercial Bank, Jedda, Saudi Arabia, pp. 1-19.

⁵⁷⁴ Issa, M. (2009), "Conflicts of interest in the work of *Sharī'ah* supervisory boards", Proceedings of Eighth Annual Conference of AAOIFI, Bahrain, pp. 1-25.

⁵⁷⁵ AAOIFI, No.1 (2008), Para. 7

in *Sharī'ah* to become an independent member and do the SSB functions as *Sharī'ah* scholars except for the right of voting on *fatwas*. The recruitment of this type of members will fill the shortage of *Sharī'ah* scholars by increasing the available number of SSB members.⁵⁷⁶

On the other hand, Al Salaheen⁵⁷⁷ recommends training the SSB members in different areas of knowledge. All Ceylon *Jam'iyyathul 'Ulama* (ACJU) of Sri Lanka's role in Islamic finance sector is not in the level of final decision maker. Even though, ACJU also conducts seminars, organises training programme and provide some valuable services for the Islamic finance. But it is not enough to develop the *Sharī'ah* governance framework in the country. Sri Lanka as a non-Muslim country, the ACJU has major responsibility to conform the Islamic financial transactions in the country are *Sharī'ah* compliant.

In conclusion, lack of proficiency and competency of Sri Lankan *Sharī'ah* governance setup is also a reason for for the inability of the industry to operate Islamic financial institutions successfully and effectively. However, there are some misconceptions regarding the *Sharī'ah* governance that is presently available. According to this study, a weak relationship between the customers/ public and *Sharī'ah* scholars of the institutions because of the lack of awareness programmes. So, the key strategies would basically involve educating the related parties through awareness programmes and training sessions by the *Sharī'ah* scholars which would create a close relationship between the public and *Sharī'ah* board members.

⁵⁷⁶ Garas, S.N. (2012) The Conflicts of Interest inside the *Sharī'ah* Supervisory Board, International Journal of Islamic and Middle Eastern Finance and Management, vol.5, No. 2, Emerald, p. 90

⁵⁷⁷ Al Salaheen, A. (2005), "Boards of *fatwa* and *Sharī'ah* supervision and their role in Islamic financial institutions", Proceedings of the Conference of Islamic Financial Institutions: Current Features and Future Horizons, University of UAE, College of *Sharī'ah* and Law, UAE, p. 261.

Another criticism that is often raised is regarding the *Sharī'ah* board members' freedom. Since the *Sharī'ah* committee members are appointed and their allowances are paid by the banks, to make the proposed products legal. If this misconception is valid it may detrimentally affect the growth of Islamic finance in Sri Lanka. Major efforts are necessary to remove this misconception.

5.4 Regulatory Challenges

The IBSL, the body responsible for the authorisation and regulation of all insurance services in Sri Lanka, applies conventional regulatory criteria and product definitions in authorising Islamic insurance institutions. Yet these institutions differentiate themselves from their conventional peers in that they house so-called *Sharī'ah* Advisory Council to audit products and services for their compatibility with Islamic principles, which developed over the course of centuries of Islamic jurisprudence. Products that comply with such principles earn the 'Islamic' label, which crucial to their uptake by Muslim investors. Therefore, *Sharī'ah* boards' major responsibility is to safeguard the religious interests of Muslim consumers. This creates a unique reputational risk in such institutions in so far as Takāful companies who have contravened the *Sharī'ah* which could trigger a lack of confidence in them.

5.4.1 Importance of Regulatory Supervision for the Insurance/Takāful Industry

The general purpose of insurance regulation is to protect the public against insolvency or unfair treatment by insurers. From the state's viewpoint, regulation is also important as a revenue producer through state taxes on insurance premiums.

The insurance business is among the types of private enterprise subject to much government regulation. It is generally classed as a business which is “affected with a public interest”. This characteristic is the reason why many forms of government supervision of insurance are deemed necessary. Although competition is an effective regulator for some businesses, in insurance uncontrolled competition would place hardship upon the buyers of insurance, most of who do not understand insurance contracts. Much of the insurance written is to protect third parties who have not participated in making the contracts. The value of the contracts depends upon the ability of the insurers to fulfil their promises to the public, sometimes many years after the signing of the insurance policy. Ability to carry out the provisions of contracts depends upon many factors, including the efficient operation of the insurer, the selection of satisfactory risks, the determination of proper premium rates, and the wise investment of adequate reserves. Consequently, the needed integrity and long range financial stability of insurers place insurance in an area which has traditionally been considered appropriate for government regulation.⁵⁷⁸

Without interfering with the freedom of the individual, one of the state’s obligations to its citizens is to protect the economy and maintain a balance between the state economy and the private market economy, such that private individuals and companies enjoy the greatest possible freedom in their dealings. In an Islamic state where the majority people are Muslims, government intervention varies from simple and unobtrusive control to a more paternalistic and close supervision of insurance business,

⁵⁷⁸ David, L. Bickelhaupt (1983). *General Insurance*, 11th Edition, Illinois (USA): Richard D. Irwin, INC., pp. 857 and 858

coupled with power to impose regulations and restrictions considered appropriate by the government to guarantee a sound insurance sector.

As far as Islamic law is concerned, some argue that if insurance is undertaken by the state, it will be clear of all forbidden elements. But the role the state should play in economic activities has not been sufficiently defined by the classical Islamic authorities. It is, however, acknowledged by modern authorities (as expressed by *Al-Majma' al-fiqhi*) that 'Islamic economic doctrine' admits the principle of private initiative and enterprise in all economic fields and projects and that the state intervenes only to ensure the success of economic ventures and the soundness of their operations.⁵⁷⁹

It is worth to point out here that supervision of insurance by the governments and its agents can keep a healthy balance between insurance companies and insured, contributing to a steady economic environment and reducing the legal claims between insured and insurance companies. This in turn saves government's time and resources.

In view of state control, to have insurance schemes that are Islamically acceptable, the schemes must show fairness between the insurance companies and the insureds to avoid the advantages insurance companies have over their customers and policyholders.⁵⁸⁰

According to Aly,⁵⁸¹ one of main purpose of state control has been to ensure that the insurer will be able to fulfil his obligations when the sum insured is due. Another

⁵⁷⁹ Sohail Jaffer (Ed.) (2007) *Islamic Insurance: Trends, Opportunities and the Future of Takāful*, London (UK): Euromoney Institutional Investor PLC, p. 181

⁵⁸⁰ Aly Khorshid (2004) *Islamic Insurance – A Modern Approach to Islamic Banking*, London (UK): RoutledgeCurzon, pp. 157 - 159

⁵⁸¹ Aly Khorshid (2004) *Islamic Insurance – A Modern Approach to Islamic Banking*, London (UK): RoutledgeCurzon, p. 159

concern is the possibility that insurers could dodge their legal obligations by drafting provisions in a way that small print (which is rarely read in full) or complicated wordings could be used to invalidate claims and avoid payments.

Three basic methods of providing insurance regulation are available to government: (1) legislation, (2) administrative action, and (3) court action. Corresponding to the three main branches of the government, each of these methods is significant in the supervision of insurance. Legislation is the foundation of insurance regulations, for it creates the insurance law. The insurance laws of each state are often combined in what is known as an insurance code, and these codes are of primary importance. Administrative action is also very important, as the application and enforcement of insurance laws are left in the hands of the insurance superintendent or commissioner in each state. Court action has great value in regulation because of its effect in providing detailed interpretations of troublesome parts of the law.⁵⁸²

According to Ali,⁵⁸³ regulatory support is a key factor for the continued development and growth of Takāful. A good example is Malaysia which has become the biggest Takāful market worldwide. This is due to the comprehensive Takāful regulations and continuous support by the regulator BNM. In Indonesia, the regulator allows conventional insurers to set up Takāful windows. Recently, Pakistan's regulator SECP (Securities and Exchange Commission of Pakistan) issued new Takāful rules allowing conventional insurers to set up Takāful windows. In Bangladesh, Insurance Act 2010

⁵⁸² David, L. Bickelhaupt (1983) *General Insurance*, 11th Edition, Illinois (USA): Richard D. Irwin, INC., pp. 860 and 861

⁵⁸³ Kazi Mohamed Mortuza Ali (2013) *Challenges of Takāful and Required Regulatory Framework*, pp. 4, 5, accessed on 15 September 2013 through <http://www.thefinancialexpressbd.com/index.php>

allows conventional life insurance companies to open Takāful windows but non-life conventional companies are barred from opening Takāful windows.

The unique characteristics of Takāful make its success somewhat dependent on a supportive regulatory framework. Malaysia is a glaring example. Some of the important features of Takāful regulation in Malaysia are as follows:

- a) An actuary is to certify pricing of Takāful products.
- b) *Shari'ah* certification is required on the operation of Takāful companies.
- c) A supreme *Shari'ah* Rules making body for Takāful has been formed by the regulator.
- d) There are limitations on the commission to be paid to intermediaries.
- e) There are specific regulations for the investment of Takāful assets.

Enacting a modern legal framework and designating a special judicial authority to handle insurance related cases are key requirements to enable market development by protecting the rights of policyholders and regulating the activities of market participants. A modern legal framework should regulate all insurance market participants, including insurance companies, intermediaries and professionals. The regulations covering insurance companies should address a number of areas, including, among others, licensing, product approval, financial reporting, investments, reinsurance, and solvency margins. In addition, and in line with IAIS principles, the regulations should stipulate the minimum internal capabilities of market players, such as governance and risk management. The regulations covering intermediaries and insurance professionals should

entail, at a minimum, qualifications criteria, licensing requirements, and a code of conduct.⁵⁸⁴

5.4.2 Regulatory Framework of Takāful in Sri Lanka

Sri Lankan Muslims even though they live as minority community, they like to organise their lives on the basis of Islamic divine rules and regulations. For instance, Amana Takāful Ltd. was launched in 1999. Because of the strong demand for the Islamic products in the financial market, conventional operators have begun to involve in this Islamic business. For instance, The Ceylinco consolidated which includes over 500 subsidiary companies started Ceylinco Takāful Ltd in 2006. The HNB Assurance commenced HNB Takāful Assurance as a window operation in July 2013. Some other conventional insurers also are planning to start Takāful windows under their conventional companies.

In countries where there is a rapidly growing demand for Takāful insurance, regulators should identify, develop, and disseminate risk management best practices that take into account the contractual relationships of Islamic insurance products⁵⁸⁵ and the regulators need to ensure the availability of training programs to educate the market on these relatively new products.⁵⁸⁶

⁵⁸⁴ Peter Vayanos (booz & co.) Promoting the growth and competitiveness of the insurance sector in the Arab world, p.11, accessed on 20 December 2012 through http://www.booz.com/media/uploads/Insurance_Sector_Arab_world.pdf

⁵⁸⁵ *Ibid*, p. 11

⁵⁸⁶ *Ibid*, p. 16

In Sri Lanka all insurance companies including Takāful companies are regulated by IBSL under the terms of the Regulation of Insurance Industry Act, No. 43 of 2000 and the circulars issued by IBSL from time to time on various specific issues.

Every company should be registered at IBSL to carry on insurance business. According to the Insurance Industry Act,

- (1) No person shall be registered to carry on, either one or both classes of insurance business in Sri Lanka, unless such person-
 - (a) is a public company incorporated in Sri Lanka and registered under the Companies Act, No 17 of 1982.
 - (b) has paid-up share capital of not less than the prescribed amount; (The minimum capital requirement for a company to seek registration is Rs. 500 million per class of insurance business.)⁵⁸⁷
 - (c) pays as deposit to the treasury such amount as may be determined by the Board, by rules made in that behalf.
 - (d) pay the prescribed fee (a sum of one hundred thousand rupees, in respect of each class of insurance business; or one twentieth of one per cent (0.05%) of the gross written premium of long term insurance business of the preceding year; and one twentieth of one per cent (0.05%) of the gross written premium of general insurance business of the preceding year)⁵⁸⁸.
 - (e) fulfil such other requirements as may be laid down by the Board by rules made in that behalf, for the purpose of ensuring the proper conduct of insurers to safeguard the interests of the insured public and for the development of the insurance industry.

⁵⁸⁷ Insurance Board of Sri Lanka, Annual Report 2011, p. 17

⁵⁸⁸The Gazette of Democratic Socialist Republic of Sri Lanka, No. 1414/19, October 12, 2005, Government Notifications, Regulation of Insurance Industry Act, No. 43 of 2000, p. 2

(2) For the purpose of paragraphs (b), (c) and (d) of subsection (1), different amounts may be prescribed for different classes of insurance business.⁵⁸⁹

Amana Takāful Ltd, the first Takāful company in Sri Lanka which was started in 1999, was in the beginning not regulated by the regulator and was under a special category. The IBSL annual report reveals that Amana Takāful Ltd, a non-conventional insurance company, carrying on both long term insurance business and general insurance business according to Islamic principles, was not regulated by the Controller of Insurance as it was exempted by the Minister of Finance under the powers vested in the Minister by the Control of Insurance Act No.25 of 1962. As the Regulation of Insurance Industry Act No.43 of 2000 did not confer any power on the Minister of Finance to exempt any insurance company from the provisions of the Act and since there were no transitional provisions permitting the continuation of this company as a licensed insurer, the Board requested Amana Takāful Ltd. to obtain registration after satisfying all the conditions required under the Act. The Company submitted the application for registration with the request that it be permitted to invest in bullion⁵⁹⁰ as Islamic principles did not permit the company from investing in interest bearing investments. The Board agreed to take steps to amend section 25 of the Act which deals with the investments of long term insurance fund and technical reserves of general insurance business to accommodate the request made by Amana Takāful PLC. This company was registered under the Act in February 2002.⁵⁹¹ The point to be noted here, is that the government authorities or relevant personals to Takāful industry have not taken initiatives or steps to form a separate Takāful

⁵⁸⁹ Regulation of Insurance Industry Act No. 43 of 2000, Part II – Registration of Insurers, section 13 (1) (2)

⁵⁹⁰ Bullion Exchange is a firm which occupies the position of being one of the largest and longest standing jewelry manufacturing in Sri Lanka.

⁵⁹¹ Insurance Board of Sri Lanka, Annual Report 2001, p.06

regulatory system in Sri Lanka as in Malaysia or regulatory provisions offering alternative financial instruments in the existing regulatory system as in United Kingdom.

According to the same source, - this happened during the period of the regulation amendments - the insurance industry is regulated and supervised in terms of the provisions of the Regulation of Insurance Industry Act No. 43 of 2000 which was enacted by the Parliament in August 2000 and came into operation with effect from 1 March 2001. The Insurance Board of Sri Lanka was established under the Act and the Board took over the regulatory function of the insurance industry from the Controller of Insurance of the Ministry of Finance who regulated the insurance industry in terms of the Control of Insurance Act No. 25 of 1962 which was repealed with the enforcement of the new legislation.⁵⁹²

Furthermore, there is no provision for a *Sharī'ah* supervisory board in any regulations or documents of IBSL. But the Takāful companies and Takāful windows have the freedom to have a *Sharī'ah* advisory council to monitor the transactions and investments to ensure that they are in accordance with *Sharī'ah* principles. Based on that, every Takāful company has a *Sharī'ah* advisory council. But this council has not been appointed according to a criteria or guidelines approved by the regulator.

5.4.3 Regulatory Issues for Takāful Industry in Sri Lanka

There is no regulatory establishment separately for Takāful insurance in Sri Lanka. Currently the IBSL under the terms of the Regulation of Insurance Industry Act, No. 43 of 2000, deals with Takāful insurance in the same conventional manner by using

⁵⁹² Insurance Board of Sri Lanka, Annual Report 2001, p. 05

the same monetary and regulatory policies. Islamic insurance in Sri Lanka is capable of operating Takāful business in compliance with *Sharī'ah* rulings despite these limitations. But according to Hifly Huzair,⁵⁹³ the Central Bank has a plan to bring a separate regulation for Islamic financial institutes in future. But right now, they do not have special regulation for Takāful.

The Takāful industry in Sri Lanka faces some obstacles to operate Islamic insurance in accordance with *Sharī'ah* due to absence of system specific regulatory supervision for Takāful insurance.

5.4.3.1 Operations of Takāful

The operating system of Takāful in Sri Lanka is fashioned by the choice of model and the nature of the contract between the Takāful operator and the participant (Policy holder). These operations must be transparent, clear and free of any tenet that may render the Takāful contract null as per laws of contracts in Islamic jurisprudence. Particularly for Takāful, these laws include ensuring that pernicious elements such as interest (*Ribā*) either in investment or operations, uncertainty and gambling is freed from the process.

It is worthy to note that the practice of conventional insurance to pay for claims and keep the proceeds is interpreted as transfer of risk and akin to gambling from *Sharī'ah* definitions.

Hence operationally, to achieve/ensure proper regulation of Takāful, regulators need proper infrastructure that enable them to supervise the operations of Takāful in a

⁵⁹³ Hifly Huzair, Manager, HNB Assurance Takāful, in the interview held on 24th August 2013.

clear and precise manner while adhering to the founding principles of *Sharī'ah*. Such enhanced regulation needs hands-on understanding of these operations to deflect the fears that “Takāful operators are just *Sharī'ah* compliant on paper”.⁵⁹⁴

5.4.3.2 Investment of Funds

Takāful operators can only invest in *Sharī'ah* compliant instruments. The regulators must then ensure that to comply with *Sharī'ah* that space is made available for developing and adapting reporting frameworks developed by the AAOIFI or the IFSB or other institutions.

In this matter, there are no Islamic investment regulations or framework included either in the Insurance Act or in the circulars issued by IBSL from time to time except some exceptions. The *Sharī'ah* Advisory Council does this job in Sri Lanka with assistance of various stakeholders such as Amana Global Ltd, IGL Lanka Limited, two subsidiary companies of Amana Takāful PLC.

According to a member of *Sharī'ah* advisory council, Amana Takāful PLC invests the contributions collected from the participants in five major avenues. First, Treasury Bills, according to the Act No. 23 of 2000, where not less than 20% of the assets of the technical reserve being maintained for a general insurance business under section 24 and not less than 30% of the assets for the long term insurance fund being maintained under subsection (1) of section 38, shall be in the form of Government Securities. The balance assets shall be in the form of such other investments as shall be determined by the

⁵⁹⁴ Abbas Mohamed, 2012. Takāful Regulation in a conventional set up, Takāful Articles, No: 24, ICMIF *Takāful*, p.2

Board.⁵⁹⁵ It is a mandatory requirement for all insurance companies. Second, in equity (share market), which are white listed companies approved by *Sharī'ah* board. Third, a portion of funds invested in bullion under guidelines prescribed by the *Sharī'ah* council. Fourth, another portion invested as fixed deposits in Islamic fully fledged banks or Islamic banking windows under the conventional banks with the limitations of the government. Finally, some of the money is invested in real estate.

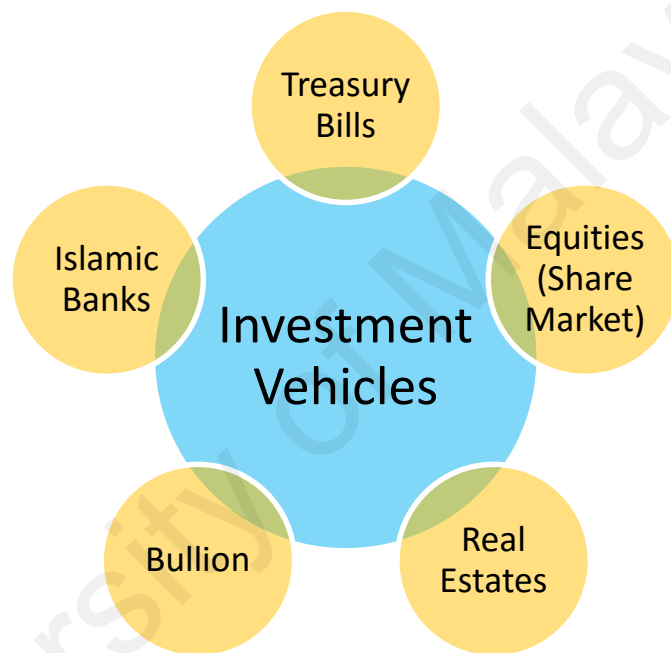


Figure 5.2: Investment Avenues of Takāful Industry in Sri Lanka

Source: Based on the collected interview data

All are fully aware that Treasury Bills are interest based instruments. Investment in those instruments has a twofold impact: it affects the revenue of the operator because interest income cannot be recognised in *Sharī'ah* and at the same time it damages the reputational or image-risk to the operator with public perception that it is indulging in non-Islamic transactions.

⁵⁹⁵ Regulation of Insurance Industry Act No. 43 of 2000, Part II – Registration of Insurers, section 25(1)

According to IBSL annual report 2005 and 2006, 15% of the share capital of Amana Takāful were held by Takāful Malaysia.⁵⁹⁶ But we could not be seen the above clause in the latest issues of the annual reports of IBSL.

5.4.3.3 Reporting and Segregation of Funds

This refers to ensuring the shareholder and risk fund resources are not mixed in the operations of Takāful. Segregation of funds ensures transparency and ownership of the funds collectively by pool members. Through segregation of funds, investment income, *Wakālah* fees, surplus/deficit can all be analysed properly. Hence, without proper segregation of funds, the Takāful concept is akin to the conventional principle and the entire program will be compromised.

The segregation depends on characteristics of the investment instruments and purposes of the investments. Accounting treatments and disclosures that Islamic financial institutions have to carry out are to be based on this segregation. Similarly, the new accounting guidance note on First Time Adoption of AAOIFI Accounting Standards provides Islamic financial institutions with the starting point for preparing financial accounting records and reports based on AAOIFI standards.

Thus separation of shareholder and participant funds, ensures proper accounting and reporting of such funds segregation and providing for clear framework which is a fundamental in Takāful operation. The key question is again is whether under conventional reporting and supervision such segregation and separation of funds can be

⁵⁹⁶ Insurance Board of Sri Lanka, Annual Report 2005, p. 16 and 2006, p. 12.

achieved? Will a mix and unclear reporting be condoned? If such separation cannot be achieved and enforced clinically, can Takāful provide optimal ethical value to users?⁵⁹⁷

5.4.3.4 Treatment of Surplus/Deficit

Surplus distribution and declaration is a significant feature in Takāful insurance. Through surplus declaration elements of uncertainty and gambling are eliminated from operation and complete equity and mutual solidarity is achieved. It is prudent that the distribution framework is also regulated at supervisory levels as this also has a further capacity to either tilt the playing field in favour of Takāful or just act as an empty promise. Indeed, there should be a clear regulatory guideline to manage this issue. Otherwise, every Takāful company or window takes the decisions on their own perception or idea as is in operation in Sri Lanka. This is the result of the absence of a Takāful regulatory code.

5.4.3.5 Retakāful Arrangements

It is an arrangement or a mechanism either by an agreement, covering a class of Takāful product or a risk by risk basis, that enables a direct Takāful operator, called the ‘cedant’, to transfer or cede the whole or a part of the risk that it has accepted, to another Takāful or reTakāful operator.⁵⁹⁸

Retakāful as well as Takāful should be *Sharī’ah* compliant as indicated in the resolution of the *Fiqh* Academy (Resolution No: 9, December 1985).

⁵⁹⁷ Abbas Mohamed, 2012. Takāful Regulation in a conventional set up, Takāful Articles, No. 24, ICMIF Takāful, p.2

⁵⁹⁸ Mohd Fadzli Yusof, Wan Zamri Wan Ismail and Abdul Khudus Mohd Naaim, 2011. Fundamentals of Takāful, p. 517.

... Commercial insurance contract commonly used by commercial insurance companies is a contract which contains major elements of risks which is prohibited according to *Sharī'ah*. The alternative for both insurance and reinsurance should be based on the principles of corporative insurance...⁵⁹⁹

Yassin and Ramly⁶⁰⁰ point out that *Sharī'ah* principles applying to Takāful also apply to retakāful. In principle, retakāful does not differ from Takāful operations; the main difference is that in the retakāful operations, the participants are Takāful operators instead of individual participants.

Based on the above quotations, Sri Lankan Takāful industry also should seek retakāful companies which operate *Sharī'ah* compliantly. In practice, all the reinsurance companies are not *Sharī'ah* compliant. For instance, Amana Takāful PLC listed its reinsurance companies. According to that its reinsurers are Best Re, Hannover Re, Labuan Re, Tokio Marine, Catlin, Malaysian Re, Trust International, ACR ReTakāful and MNRB.⁶⁰¹ There may be Justifications for this practice of using conventional reinsurers. Whatever the case may be, this is mainly it is due to the lack of a regulatory framework for Takāful insurance in Sri Lanka.

In conclusion, Sri Lanka is a Muslim minority country, we cannot treat the situation here as in the Arab countries or Muslim majority countries. This community has unique problems, circumstances, pressures which are not available to the Muslim communities live in other countries. Sri Lankan Insurance Regulator (Insurance Board of Sri Lanka) considers Takāful companies as similar as conventional insurance companies with some relaxations of rules. Due to absence of Takāful Act or special regulatory

⁵⁹⁹ *Majma' al Fiqh al Islami al Duwali*, Resolution No: 9 (9/2) on Insurance and Reinsurance, Jeddah, KSA, December 1985.

⁶⁰⁰ Nasser Yassin and Jamil Ramly, 2011. *Takāful: A Study Guide*, Kuala Lumpur, p. 250

⁶⁰¹ Amana Takāful PLC, Annual Report 2012, pp. 137, 138

provisions for Takāful industry in Sri Lanka, it is hard to operate the Takāful insurance on a 100% on *Sharī'ah* compliant manner in this country. The two legal maxims “Necessities permit prohibitions” and “Necessities estimated with their limitations” are relevant in this context. The *Sharī'ah* advisory council plays a significant role in the Takāful industry in Sri Lanka. They are responsible to formulate policies and guidelines for operation and management of Takāful business in line with *Sharī'ah* principles as well as *Sharī'ah* monitoring and auditing. Indeed, they act as *Sharī'ah* regulatory body of Islamic insurance in Sri Lanka.

5.5 Conventional Insurance Companies

Besides this, working in a competitive environment side by side with conventional insurance companies is, in itself, a challenge. Takāful companies must offer competitive products/services in terms of price, quality of coverage and delivery time. They will have to work with a new mindset, avoiding malpractices and using the best professional expertise. Policy holders also need to support Takāful companies and be proactive to ensure that the companies are competitive and their operations are *Shari'ah* compliant in all respects.

According to the annual report of IBSL for the year 2014, there are 21 companies registered as insurers under the Companies Act, (No. 7 of 2007) as at the end of the year. Out of the 21 companies, 12 companies are registered as composite insurers, carrying on both long term insurance business and general insurance business, three companies are registered to carry on long term insurance business and six companies are registered to carry on general insurance business.⁶⁰² It indicates that Amana Takāful PLC as a fully

⁶⁰² Annual Report, 2014, Insurance Board of Sri Lanka, p. 108

fledged Takāful player has to compete with 20 other conventional insurance companies. Comparatively, some of them are very huge companies in terms of gross written premiums, assets, accessibility, experience and state support.

Fazal Ghaffoor⁶⁰³ says there are four main challenges from conventional insurance companies. The principle challenge from them is pricing.⁶⁰⁴ We are transparent. We tell them this is how we price, this is the Takāful contribution put into the *tabarru'* fund, all that which the conventional does not do. But we have to according to the Takāful concept lay this upfront. Conventional insurers do not have to tell you all these. So, that is one of the challenges of transparency we have to maintain. Hifly Huzair⁶⁰⁵ explains the background. In Takāful the contributions go through two ways. One is management fee and other one is for investment. Based on that, we cannot compete on price. We cannot go for very low price. There is a disadvantage in pricing. Conventional insurance companies can go on price cutting, they take that advantage. Because of they have a free hand in investment. So, that is a main factor or main problem that we face when we compete with conventional insurance.

Number two is discounting.⁶⁰⁶ There is a limit what we can discount. We cannot go beyond that. Third one is doing business with a company which has multiple business lines, let's say John keels holdings, they have their portfolio with several businesses including a liquor arm. We cannot say we will take everything other than liquor. They say look you take all or nothing. So we are a little handicapped. *Sharī'ah* scholars worldwide, have said if such portions of business are no more than 5%-7% you can

⁶⁰³ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

⁶⁰⁴ Ashik, M.M.M., Branch Manager, Kurunegala Branch, Amana Takāful PLC, in the interview held on 26th August 2013.

⁶⁰⁵ Hifly Huzair, Manager, HNB Assurance Takāful, in the interview held on 24th August 2013.

⁶⁰⁶ Fazal Ghaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013.

underwrite. If you look at these challenge for competitors it reflects on share price. Their shares are trading very well. They do not fear price cutting. They can put it into areas which are not defined in *Sharī'ah* restrictions that we have. So they can make good money. The fourth one is that they are able to get a better reinsurance worldwide. So, those are the challenges.

According to Ashik,⁶⁰⁷ service and price are the challenges. The conventional insurance companies address the problem immediately. The service speed/time is the different. Obviously, for an example, if anyone has a small claim and submit the relevant documents, he/she can get it in the evening on the same day from the conventional insurance companies. The similar service we have in our head office, Kandy and Galle branches. We do not have in this branch. If we upgrade our level to that level, we can compete with them easily. And Rahman⁶⁰⁸ says another two challenges faced by the Takāful industry in Sri Lanka are that the conventional insurers offer good salaries and facilities to attract our good employees.

According to the interview conducted by the researcher, the customer satisfaction is at a respectable level. When the researcher asked them about their perception about the received claims and services from Amana Takāful, the seven out of 20 respondents (35%) replied that it was excellent, five said it was good (25%), six respondents it was fair (30%), one said it was bad (5%) and one said it was terrible (5%). When analysing these figures, we conclude that more than half of the customers are in favour of services obtained from Amana Takāful when claims were made and other services. All together

⁶⁰⁷ Ashik, M.M.M., Branch Manager, Kurunegala Branch, Amana Takāful PLC, in the interview held on 26th August 2013.

⁶⁰⁸ Rahman, S.M.M., Branch Manager/Life, Kalmunai Branch, Amana Takāful PLC, in the interview held on 11th July 2013.

90% of the customers are of the view that services of this company are at a satisfactory level. This is a very positive response.

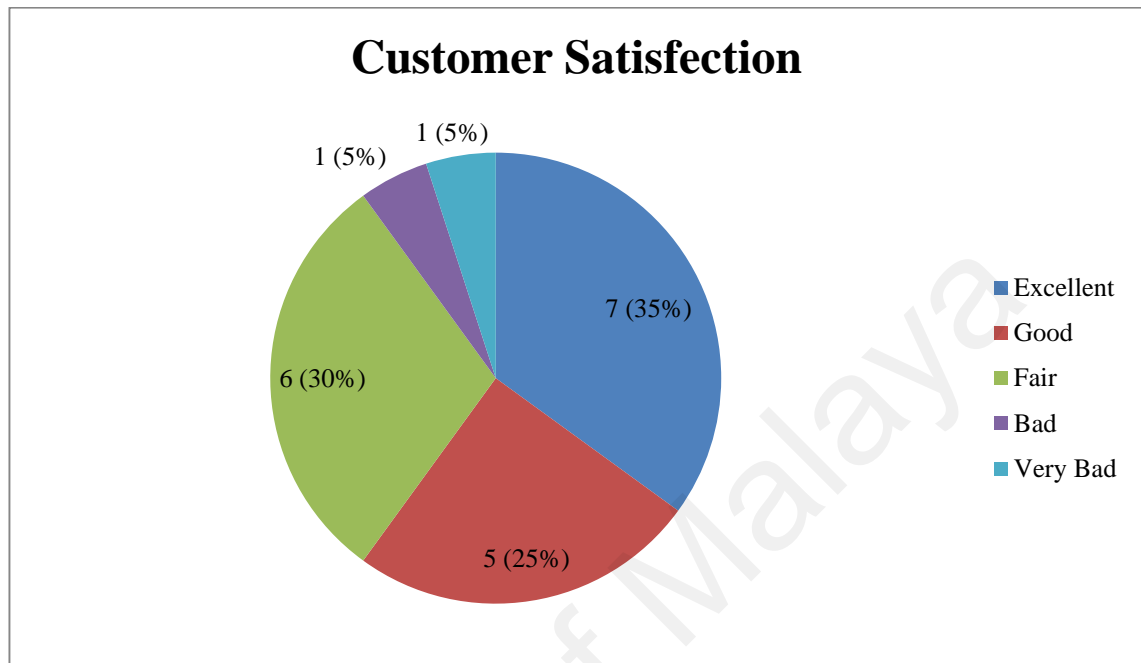


Figure 5.3: Customer Satisfiection Level

Source: Based on the collected interview data

At the moment, the situation is further improved according to Mohideen.⁶⁰⁹ He says that conventional insurance companies were objecting and placing various obstacles on Takāful companies. Individually we have to overcome all that, luckily Amana Takāful was very strong and they had some key powerful people with them like Faiz Musthafa⁶¹⁰. They were very powerful and if they needed anything they can get it legally. In that way the credit should go to Amana Takāful.

⁶⁰⁹ Mohideen, S.A.H., Former Chairman, Ceylinco Takāful Ltd., in the interview held on 22nd August 2013.

⁶¹⁰ One of the President's Counsels in Sri Lanka (President's Counsel is a professional rank, which is recognised by the courts and is equivalent to the rank of Queen's Counsel in the UK – the holder can use the designation PC after his or her name.) and he is recognised, well known as a 'leading appellate lawyer'.

5.6 Investment Oriented Challenges

Fisher and Taylor made a very interesting comment that to check whether a company's operation is *Sharī'ah* compliant or not one has to look at its investment portfolio. They mentioned when faced with the issue of determining if a cooperative insurance company can be considered as *Sharī'ah* compliant or not, the first question to be asked before considering all of the other important, but to a degree less significant features is, "are the investments undertaken by the company fully and totally *Sharī'ah* compliant"? Only if the answer is affirmative it is necessary to move on to consider the other *Sharī'ah* compliant features detailed to determine if an insurance operation is *Sharī'ah* compliant or not. If an insurance operation fails this initial *Sharī'ah* compliant investment "litmus test", it cannot be *Sharī'ah* compliant, even if it is cooperative. This shows that investment into permissible areas under *Sharī'ah* is very important and crucial element in order to stay *Sharī'ah* compliant.⁶¹¹

The following figure shows the difference between the conventional and *Sharī'ah* compliant investments:

⁶¹¹ Qureshi, A.A., 'Analysing the *Sharī'ah* compliant issues currently faced by Islamic Insurance', Interdisciplinary Journal of Contemporary Research in Business, vol. 3, No. 5, September 2011, Institute of interdisciplinary research, p.285

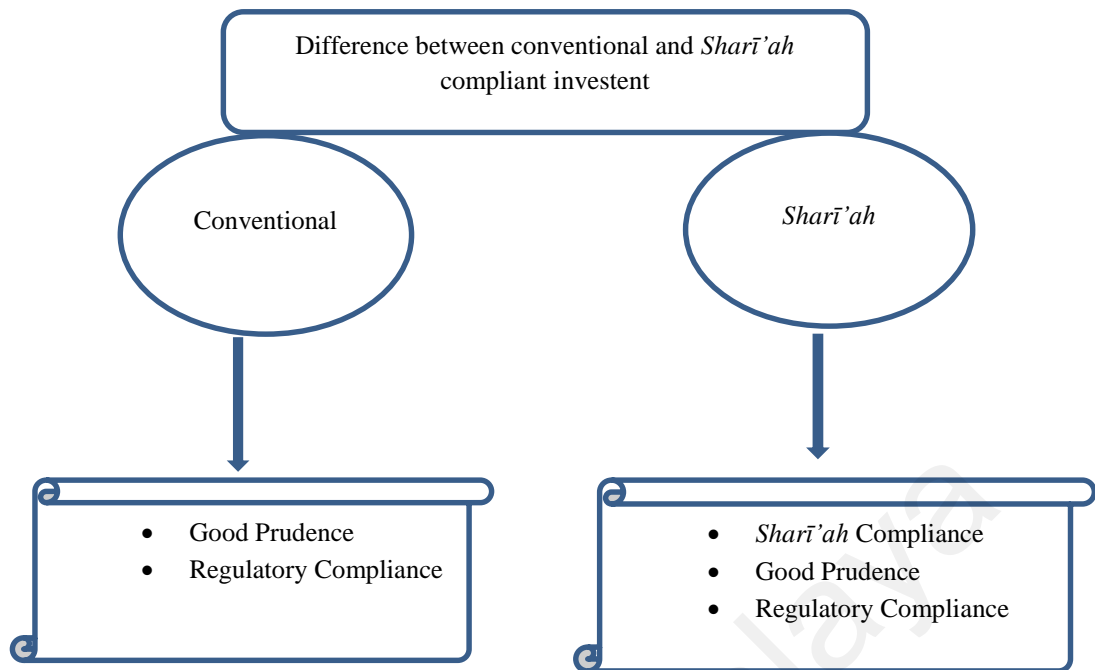


Figure 5.4: Difference between Conventional and *Sharī'ah* Compliant Investment

In service industries examples of prohibited activities are interest based financial institutions, conventional insurance companies and entertainment industry involved in pornography, gambling etc. Likewise in manufacturing, processing, and trading the prohibited areas are alcoholic beverages, tobacco products, pork or using any ingredient/s obtained from pork and arms & ammunitions. There are some financial limitations such as avoid association with interest, leverage i.e. debt equity ratio, cash and receivables to total assets ratio. The above list is not exhaustive. Some of the instruments that are available for Takāful operators to invest include equities, Islamic private debt securities such as *Sukūk*, Islamic financing facilities, property, Islamic deposits, government issuance and Islamic unit trusts.

In spite of the growth of Islamic finance, Takāful, and the global *Sukūk* markets, there is still a shortage of tradable *Sharī'ah* compliant assets in the market. The

key challenges faced by operators with respect to investment strategy can be summarised as follows: The lack of suitable (*Sharī'ah* compliant) investment vehicles, particularly those with longer term duration. There are a number of hurdles related to *Sharī'ah* compliant assets in which companies must invest the contributions made by Takāful participants.

The continued success of the Takāful industry is linked to sound *Sharī'ah* compliant asset management capabilities. Both the shareholders' fund and the policyholders' pool need to be invested in *Sharī'ah* compliant avenues in a profitable manner. The development of a strong asset management capability will enable a stronger Takāful proposition. The lack of suitable assets with sufficient liquidity remains a big challenge in the Takāful industry.

Based on those developments, Zaid Aboobucker⁶¹² says that the challenge is principally in investment. We cannot invest the contribution anyway we want. We have to invest following the government's investment guidelines. On the positive side, they have given some leverage for the sake of Takāful. For instance: A big segment of investment is on non-*Sharī'ah* compliant instruments. *In sha Allah* we are confident that it will be favourable in the future.

We have to invest under the regulations. If they permit 5% of investment in the gold, we have to use only 5%. No more. A similar circumstance is in the real estate and equity Islamic investment. The specified percentage should be invested in treasury bills. We cannot say "no". We can invest under the *Sharī'ah* regulations in bullion, real estate

⁶¹² Zaid Aboobucker, General Manager/Operation and Medical, Amana Takāful PLC, in the interview held on 19th August 2013.

and equities (selected companies). But we face problems in investing in these avenues also because of instability of price. For instant, last year gold market is very profitable, but not this year. The same applies to real estate. We have a separate treasury unit to look after these things.

Murshid Mulaffar⁶¹³ explains the current situation of investment of Takāful industry. He says that another challenge is investment restriction. If we can invest in foreign or increase the limitation of investment in the existing Islamic banks, it will be a big relaxation. A huge amount of our money in treasury bills without any return. Indeed, the obstacle facing Takāful Companies in Sri Lanka is to survive or perform well with good investment returns. If the government permits the 30% or 25% now invested in treasury bills to be invested - in *Sukūk* or foreign investment, we would be in commanding position in performance. All other companies show profitability because of high investment return. They invest 90% of their premiums in treasury bills. They are not investing in real estate or equity or bullion. Treasury bills are fixed interest income investments free of all hassle. They survive and perform well because the high investment return. The challenge for the Takāful is that they are compelled to invest in treasury bills and get no return.

Mansoor⁶¹⁴ reveals another constraint in the Takāful investment process. It is lack of professional competency in the Takāful industry. When we invest the funds of participants employing high quality professionals, this is missing in the Takāful industry. Another constraint faced by Islamic banks and Takāful companies in Sri Lanka is the lack

⁶¹³ Murshid Mulaffar, M., Secretary and in-house Supervisor, *Shari'ah* Supervisory Council, Amana Takāful PLC, in the interview held on 19th August 2013.

⁶¹⁴ Mansoor, M.A.M., Director, Mishkath Institute for Islamic Research, Akurana, in the interview held on 16th August, 2013.

of research into current market opportunities, study market trends, investment avenues, trustworthy personals etc. Most of the bankers argue that they do not involve heavily in *Muḍarabah* investments because of the lack of trustworthiness among people. This is wrong.

5.7 Marketing Challenges

Marketing is an important component of any business that is driven by commercial targets. The Takāful industry is also a business venture combined with social service. In this regard, they also have to use modern, sophisticated methods and strategies to attract people to participate in the Takāful system. Otherwise, they will not develop the industry and eventually the Takāful concept will fail and its benefits will not reach common people.

In the Sri Lankan context, marketing of Takāful products is a big challenge as Ifthikar⁶¹⁵ says marketing by itself is a challenge and especially so for the Takāful industry because we have to explain a novel thing to the clients and our base is also non-Muslim base. It is very difficult for us to convince the customer. But by explaining the benefits they will appreciate our concept and practice. They understand the higher returns they get compared to conventional insurance as they already have experience with conventional insurance. Takāful is a novel thing which they wish to try out.

⁶¹⁵ Ifthikar, N.M., Regional Manager, Central Region, Amana Takāful PLC, in the interview held on 07th August 2013.

Murshid Mulaffar⁶¹⁶ explains our price is normally higher than others. Conventional insurance companies are prepared to give it at half price, because their investment returns are high. There is no other way for us to move forward except providing a high level service. Sometimes the Takāful windows tackle this issue. For instance, HNB Assurance and HNB Assurance Takāful are a company in the eyes of the government. When they are required to invest in treasury bills, they can use conventional insurance money to cover it and they can invest 100% of Takāful money in those avenues permitted in Islamic law. In this way they can minimise the effect of this problem. This situation is however a major challenge for Amana Takāful which is a stand-alone Takāful company. It is a challenge within the industry.

Hifly Huzair⁶¹⁷ says in the side of marketing, the amounts that conventional insurance companies spend for promotion and all other propaganda activities is very high. Because of their vast resources they can have a separate advertising fund. Because of limited resources of income, Takāful companies do not have that amount of money on advertising and business promotion. In that sense, we are not in a position to compete with them on that level.

In practice, the Takāful agents face another important financial problem when they introduce Takāful products to customers. Mafahir⁶¹⁸ says that there is commission for Takāful agents in marketing. The commission is more in the first year, less in the second, low in the third year and no commission for fourth year onwards. The agent gets 30% of the basic payment if the customer pays it annually. If it is half-yearly payment,

⁶¹⁶ Murshid Mulaffar, M., Secretary and in-house Supervisor, *Shari'ah* Supervisory Council, Amana Takāful PLC, in the interview held on 19th August 2013.

⁶¹⁷ Hifly Huzair, Manager, HNB Assurance Takāful, in the interview held on 24th August 2013.

⁶¹⁸ Mafahir, M.M.M., Takāful Agent, Amana Takāful, in the interview held on 17th August 2013.

he will get 25%. He gets 20% for monthly payment. This is for the first year. In the second year, it will be half this amount. In the third year, it will be half of the amount paid in the second year. Generally, an agent goes into remote areas and collects policies. The percentage he gets is high in the first year. Therefore, it will be profitable for him. Second year he can manage. Third year onwards he gives up the old customers because of less income. And the company pressures the agent to show monthly target with new customers. The agent also looks into the new customers, because of more income. In this regard, the customers suffer and the company will lose the customers. This method is outlined by the company.

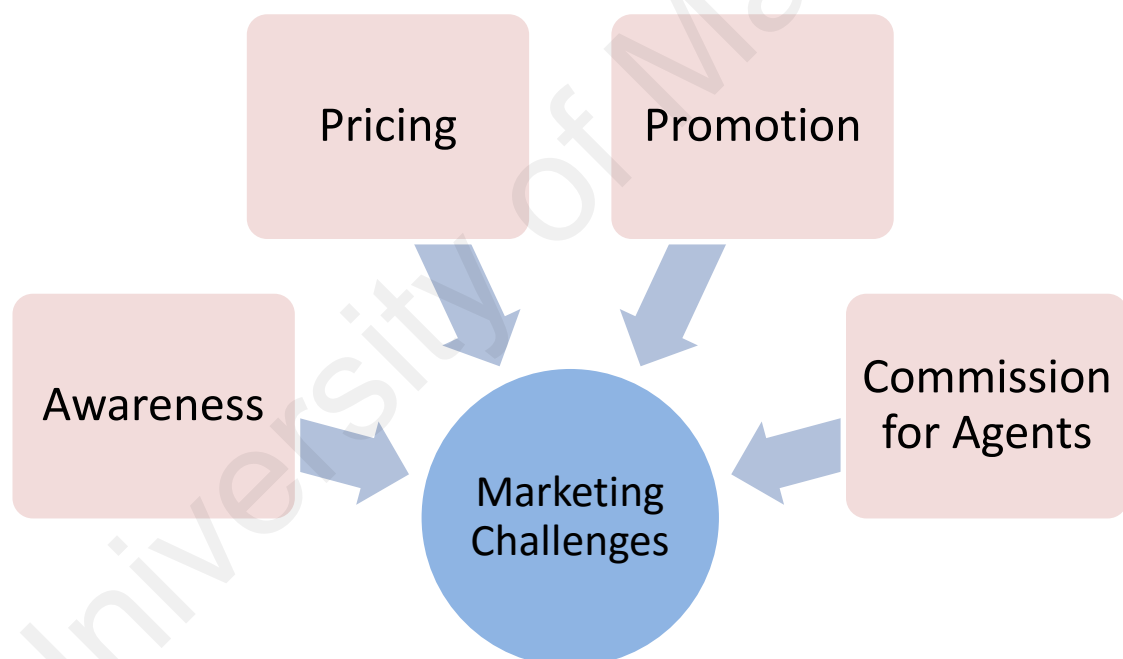


Figure 5.4: Marketing Challenges

Source: Based on the collected interview data

Even though the above situation exists, some of the agents⁶¹⁹ consider working as an agent is a religious obligation because they are working at a *Shari'ah* based company

⁶¹⁹ For an example, Rinas, M.M.M., Junior Sales Executive, Amana Takāful, in the interview held on 17th August 2013

that operates on the Islamic concept and they have a great opportunity to learn about Islamic doctrines.

According to the annual report of IBSL, there is a very clear increase in branches, employees and agents of insurance industry of Sri Lanka including Takāful. There were 1,379 branches in 2013 and in 2014 they were 1,462 (6% growth). Number of Employees who were in the staff of all insurance and Takāful companies was 13,764 in 2013 and 16,134 in 2014 (17% growth). Similarly, in 2013 the number of agents was 38,635 and they were 42,958 in 2014 (11% increase). The following table discloses the details of the above mentioned theme on provincial level, comparing year 2013 with 2014.

Table: 5.1: No. of Branches, Employees and Agents

Province	No of Branches		No of Employees		No. of Agents	
	2013	2014	2013	2014	2013	2014
Central Province	126	159	1,031	941	3,820	4,370
Eastern Province	96	104	404	506	1,773	2,310
North Central Province	97	109	603	679	2,324	2,752
North Western Province	126	133	749	725	3,613	3,898
Northern Province	108	111	421	400	2,945	3,369
Sabragamuwa Province	104	92	535	561	2,611	2,209
Southern Province	176	191	1,046	1,137	4,637	5,275
Uva Province	67	76	382	405	2,294	2,197
Western Province	489	487	8,613	10,780	14,618	16,578
Total	1,379	1,462	13,764	16,134	38,635	42,958

Source: Annual Report of Insurance Board of Sri Lanka – 2014

5.8 Retakāful Related Challenges

Bank Negara Malaysia has set a guideline for Takāful operators. The bank included guidelines for retakāful activities too. In the guidelines for retakāful arrangements, it declares:

As part of good risk management, Takāful operators must have in place effective retakāful management strategy which is appropriate to the overall risk profile of the Takāful business. Takāful operators are also expected to monitor, review and update the retakāful management strategy on a regular interval in response to changes in the Takāful funds' risk profiles.

Takāful operators are expected to secure retakāful arrangements which commensurate with the size, business mix and complexity of the Takāful business. The retakāful arrangement must be consistent with the interests of the Takāful funds, and achieve the objectives of risk mitigation that protect the solvency of Takāful funds and ensure the funds' ability to pay liabilities when due. Strength of the retakāful operators must be the main consideration, as effective risk mitigation can only be achieved if the retakāful operator is financially sound. The amount of business to be ceded as retakāful must be in line with the level of risk tolerance of the Takāful funds and/or the Takāful operators, taking into consideration availability of capital or surplus to cushion future contingencies.

Takāful operators must ensure that the retakāful arrangements are well diversified to avoid over-concentration of risks. In addition, any commissions receivable or profit sharing arising from the retakāful arrangement shall be fairly redistributed to the relevant funds taking into consideration the source of the retakāful contributions and the performance of the funds leading to the commissions or profits.⁶²⁰

⁶²⁰ Guidelines of Takāful Operational Framework, Bank Negara Malaysia, pp.11 and 12

Sharma mentions that *Sharī'ah* compliant insurance companies require reinsurance facility to transfer the risk, reduce aggregation, limiting claims volatility and protection of assets. The numbers of *Sharī'ah* compliant reinsurance providers are not enough to cater for the reinsurances of all *Sharī'ah* compliant insurance companies. As such, many *Sharī'ah* compliant insurance companies place their reinsurances with conventional reinsurers under the 'doctrine of necessity'. However, this is being done as a result of the doctrine of necessity but strictly speaking this Takāful insurance practices are inconsistent with *Sharī'ah*.

Participants in Takāful insurance pay contributions which are then transferred by *Sharī'ah* compliant insurance company to conventional reinsurers. The funds of Islamic investment product and those of financial institution which are invested in non-*Sharī'ah* compliant operations must be completely segregated. Even if the reinsurance is placed with conventional reinsurance on a 'doctrine of necessity', the funds of investors who are pious and are anxious to earn income only from shariah compliant sources should not be mingled with those of conventional investors who are not observant of *Sharī'ah*.⁶²¹

Yaquby raises a very valid and thought provoking issue. He says that conventional financial institution's 'Articles of Association' do not mandate compliance of their business activities with the tenets of *Sharī'ah*. To attract the business of Islamic insurance companies conventional reinsurers set up *Sharī'ah* reinsurance windows or funds that often claim that their transactions and dealings fully complying with the provisions of the *Sharī'ah*. But when subjected to scrutiny and examination, this proves otherwise.

⁶²¹ Qureshi, A.A., 'Analysing the *Sharī'ah* compliant issues currently faced by Islamic Insurance', Interdisciplinary Journal of Contemporary Research in Business, vol. 3, No. 5, September 2011, Institute of interdisciplinary research, pp. 289 and 290.

Sharī'ah compliant insurance companies are required to reinsure their risks with *Sharī'ah* compliant reinsurers on retakāful basis. According to the Islamic Banking and Insurance Encyclopaedia, due to the meagre reinsurance capacity of retakāful operators, latitude has been granted by *Sharī'ah* advisors to cede primary Takāful premiums to conventional reinsurers. Such dispensation is understood to be for a temporary period and lay down the challenge to Takāful and retakāful operators alike to work towards for a swift resolution of these anomalies.

The Islamic insurance and investment report mentions that reinsurance of Takāful business on *Sharī'ah* principles has been an area of much debate. Reinsurance on *Sharī'ah* principles is known as retakāful. The problem has been the lack of Takāful companies in the market. This has left the Takāful companies with a dilemma of having to reinsure on conventional basis, contrary to the customer's preference of seeking cover on *Sharī'ah* principles. The *Sharī'ah* scholars have allowed dispensation to Takāful operators to reinsure on conventional basis so long as there was no retakāful alternative available. Takāful companies therefore actively promote coinsurance. A number of large conventional reinsurance companies from Muslim countries take on retrocession. Still there is a lack of capacity within the Takāful industry worldwide. A certain proportion of risk is placed with international reinsurance companies that operate on conventional basis. The retrocession from Takāful companies' ranges from some 10% in the Far East where Takāful have relatively smaller commercial risks (so far), to the Middle East where up to 80% of risk is reinsured on conventional basis.⁶²²

⁶²² Qureshi, A.A., '*Analysing the Sharī'ah compliant issues currently faced by Islamic Insurance*', *Interdisciplinary Journal of Contemporary Research in Business*, vol. 3, No. 5, September 2011, pp.290 and 291, Institute of interdisciplinary research.

It should be noted that *Sharī'ah* compliant insurers pass contributions to conventional reinsurer who may then invest these funds in the areas and in the manner not permissible in *Sharī'ah* and conventional financial institutions in managing investments has taken several forms.

An Islamic financial institution (IFI) offers an investment portfolio, backed by its *Shari'ah* scholars, but vests management of this portfolio in an external investment manager who undertakes to comply with the IFI's conditions and applies the criteria and standards laid down by the IFI when managing investment. This is permissible under *Sharī'ah* if the investment manager complies with the Islamic conditions and his or her success has been proven in more than one instance.

Alternatively, a conventional financial institution or reinsurance opens the “*Sharī'ah* window” on its premises, introduces an investment product marketed as “*Sharī'ah* compliant,” such as a fund, or sets up *Sharī'ah* reinsurance.

Some scholars believe that this is not permissible, because conventional financial institutions or reinsurance do not comply, in the first place, with *Sharī'ah* principles in their incorporation documents and connected statutes. If they do not recognise *Sharī'ah* in their basic charters, how can they claim to comply with it in their management of funds, branches, or windows? They do not intend to run the institution incorporating the Islamic principles.

In addition, the funds of these conventional financial institutions or reinsurance are drawn from prohibited earnings, so how can they invest unlawful funds in *Sharī'ah* products? The rationale cited by scholars is that these financial institutions are only intent

on exploiting practicing Muslim investors and in so doing unfairly compete with *Sharī'ah* compliant financial institutions.

It must also be said that the claim that traditional financial institutions desire to unfairly compete with *Sharī'ah* financial institutions can be refuted by saying that competition is always in favour of the most suitable, efficient, and fittest. This kind of competition may prompt *Sharī'ah* financial institutions to exercise more diligence and care to introduce better quality products and conduct their activities more efficiently.

On the other hand, conventional financial institutions may gradually convert their operations in full or in part into full-fledged IFIs if they find this viable and if they have acquired adequate practical experience and knowledge of *Sharī'ah* practices in this field. There are practical examples to substantiate this argument.

Among scholars and jurists who hold this view are Yusuf Al Qaradawi, Abdulsattar Abu Ghuddah, M. Taqi Usmani, Nazih Hammad, Abdullah Al Muslih, and Abdullah bin Sulaiman Al Manea. Economists who also espouse this view include M. Ali Elgari and Monzer Kahf. They all concur that the required conditions, outlined below, necessitate strict compliance.⁶²³

The dilemma has been the very slow growth in numbers of *Sharī'ah* compliant reinsurers. The Middle East based *Sharī'ah* compliant insurance company's reinsurance has mostly been placed with European conventional reinsurers and these reinsurers do not follow *Sharī'ah* principles.

⁶²³ Qureshi, A.A., 'Analysing the *Sharī'ah* compliant issues currently faced by Islamic Insurance', *Interdisciplinary Journal of Contemporary Research in Business*, vol. 3, No. 5, September 2011, p. 292, Institute of interdisciplinary research.

However, the situation is gradually changing; though very slowly, as well-established conventional reinsurers now entering the field of *Sharī'ah* compliant reinsurance to cater to their customers' need. Some of these major conventional reinsurers who have formed Retakāful pool/Arms/Division are Swiss Re, Mitsui Sumitomo, Munich Re, Hannover Re, Tokio Marine Re-Takāful, Labuan Re and Trust Re.

Retakāful availability is a problem, as only a few companies are providing retakāful facilities in Malaysia, UAE, Bahrain, and Saudi Arabia, and that too on a *Muḍārabah* basis, which is objectionable according to some scholars.

Murshid Mulaffar⁶²⁴ states that Amana Takāful PLC has challenges in the area of retakāful. Existing retakāful companies are not strong enough to retakāful big institutions. In this situation we have to go to reinsurance. This is a huge challenge in Maldives than it is in Sri Lanka. Zaid Aboobucker⁶²⁵ says that the retakāful problem is now slowly improving but it has to be developed globally.

5.9 Other Challenges

Other than the challenges mentioned above, Muath⁶²⁶ says market reach out is a challenge for the industry. They do not have branches or service stations in critical places in the island. For instance there is no branch of Amana Takāful PLC in Anuradhapura,

⁶²⁴ Murshid Mulaffar, M., Secretary and in-house Supervisor, *Sharī'ah* Supervisory Council, Amana Takāful PLC, in the interview held on 19th August 2013.

⁶²⁵ Zaid Aboobucker, General Manager/Operation and Medical, Amana Takāful PLC, in the interview held on 19th August 2013.

⁶²⁶ Muath, M.B.M., Head of Finance and Corporate Strategy, First Global Group, Colombo, in the interview held on 26th August 2013.

Nuwaraeliya, Badhulla, Banadarawela, Mannar, Moneragala areas as these are commercially important places in Sri Lanka.

Skills shortage is another challenge. Even though there are many educated people, experts in Takāful, professionally qualified chartered insurers (Muslims) in Sri Lanka, we do not use them properly.

Another challenge is lack of a mechanism for transparency of operations. On the theoretical principle customers should know, policy holders should know what is happening and what is going on in the Takāful company as conceptually they are partners of the Takāful fund. But there are no systems to show transparency.

A respondent⁶²⁷ expressed the opinion that the Takāful industry must build trust among all stake holders in the Takāful industry including ordinary people. People generally say that Takāful operators are only doing business in the name of Islam. We have to change this mentality. Paying Takāful claims is the main thing. If we do not honor the contract with customers sincerely, they will distrust us. The important point is that they have to disclose on what basis they reject the claims. The rejections are justified by Takāful operators citing practices based on general insurance law. I am not aware that is there is justification in *Shari'ah* to reject these claims. If the rejection is on *Sharī'ah* grounds then there is no problem. But in most cases this is not the case.

⁶²⁷ A respondent who does not will to reveal his name, in the interview held on 24th August 2013.

5.10 Conclusion

The Sri Lankan Takāful industry is facing many challenges when they operate Takāful as a *Sharī'ah* compliant vehicle under the rules and regulations of the land where non-Muslims are the majority live. In that background, Takāful operators face some critical issues. The researcher identified and listed those challenges in eight components. They are public awareness, lack of expertise & trained staff, regulatory challenges, conventional insurers, investment, marketing, retakāful and other challenges. These key factors were analysed in this chapter through the opinions of overseas experts in the field, the assessments of Takāful operators including *Sharī'ah* supervisors and the ideas of prominent Muslim scholars who observe the situation locally.

CHAPTER 6: FINDINGS, SUGGESTIONS AND CONCLUSION

6.1 Introduction

This study was designed to assess the state of Takāful insurance in Sri Lanka by examining the developments achieved by the Takāful operators and the challenges faced by the same industry. This concluding chapter presents information derived from the study in three sections. The findings from both the literature review and the field investigation on the developments and challenges of Islamic insurance in Sri Lanka are presented in first section. The second section presents suggestions in detail with recommendations of Takāful practitioners, *Sharī'ah* scholars and customers. The final section offers conclusive remarks on the study.

6.2 Findings

The following research findings were reached in this study. These findings are discussed below under topics of assessment of current state of *Takāful* in Sri Lanka, its developments and the challenges.

6.2.1 Assessment of Current State of Takāful in Sri Lanka

The people of Sri Lanka, particularly Muslims, faced two calamities in recent years. Sri Lanka was hit by a tsunami triggered by an earthquake off the coast of Sumatra in December, 2004, tendering more 35,000 people dead, around 800 thousand people homeless and widespread of damages in the country. The Eastern shores where the

Muslims of Sri Lanka are a majority was severely affected. They lost not only their lives in thousands but also their properties and belongings.

The other tragedy was three decades of civil war due to ethnic deviations between the Buddhists majority and the Hindu minority. As a result, more than 80 thousand civilians lost their lives and hundreds of thousands of people were displaced. The Muslims lived in Northern Province were forcibly evacuated from their motherland. The Eastern Province Muslims also severely faced challenges for their lives and properties. Although this war ended in May 2009, ethnic division and human rights issues remain unsettled in the country.

After ending the war in 2009, Muslims, the second minority of Sri Lanka, are facing threats from Buddhist extremists groups led by some Buddhist clergy. This led Muslims to face some unwanted problems resulting in conflicts, casualties, and assassinations. Based on the foregoing background, the necessity for protection is being felt among Muslims. This situation warrants them to get Takāful policies as it has government security and religiously accepted edicts.

With the emergence of Islamic banks and banking windows in Sri Lanka, the knowledge and awareness on Islamic financial concepts and products were also felt to a certain extent. Amidst numerous challenges, the Islamic banking and Takāful industries cooperated to advance the Islamic finance in the island. In this context, Takāful has emerged to be an important component of the Sri Lankan banking and financial system. It is a favourable environment to grow Takāful in Sri Lanka.

The credibility towards the Takāful companies is increasing among Muslims and non-Muslims. The Muslims of Sri Lanka represent approximately 10% of the total population. However, most Muslims are either uninsured or underinsured by Takāful due to several reasons. For instant: majority of Muslims are uninterested in insurance activities, because of their mentality that the insurance is against the Islamic religious doctrines. Most of them get motor Takāful / insurance (third party) due to the legal enforcement.

At present, General Takāful especially motor Takāful is well accepted in the market. If the Takāful industry takes vigilant steps to introduce and explain the family Takāful segment to the public through available propaganda channels it will get a good opportunity for family Takāful to grow rapidly in Sri Lanka. Lack of awareness on Takāful or misunderstanding of Takāful is the main obstacle to reach the people.

As we noted earlier, Takāful does not need to be limited to the Muslim community. In Sri Lanka with a significant Muslim population, there is a potential market among non-Muslims, despite the obvious religious and cultural differences. They constitute 90% of the population and their awareness on insurance is higher than Muslims. The Takāful concepts and policies can be reached them if the Takāful industry in Sri Lanka focuses on the characteristic features of Takāful, without focusing on the religious aspects of Takāful. There is a certain percentage of non-Muslims who dislike interest, gambling, and other unethical activities. Moreover, an element of profit sharing, transparency over product profitability, and the limitations on acceptable investment may be attractive to the growing “ethical investment” segment. There is a huge potential in non-Muslim market, if the Takāful industry of Sri Lanka can focus on customer care, product innovation, and confidence in the system.

6.2.2 Takāful Developments in Sri Lanka

The developments of the Takāful industry of Sri Lanka have been examined from Islamic jurisprudential and business development aspects.

6.2.2.1 Jurisprudential Developments

In terms of the Takāful operational model practiced in the Sri Lankan Takāful industry, all the operators are not following the same model. But as in the international scenario, every company follows separate model for their operations. Due to the absence of Takāful regulatory body in Sri Lanka, there is no unanimous decision taken in the matter of operational model. Most of the jurists agree that the *Muḍārabah* model which consists Islamic jurisprudential arguments on its permissibility is not acceptable while it was the initial model used at Amana Takāful PLC. It can be construed that selecting well recognised *Wakālah or/with Waqf* models is a development process in the Takāful industry in Sri Lanka.

In terms of standards followed by the Takāful companies in Sri Lanka, they unanimously agreed to follow AAOIFI standards due to AAOIFI's world class reputation among the operators and intellectuals. *Shari'ah* Supervisory Councils of Takāful companies in Sri Lanka have got a mechanism to reach solutions for problems not addressed by the AAOIFI standards. They seek *fatwā* from prominent *Shari'ah* scholars or they take their own decisions considering *Shari'ah* rules and the law of the land. For instant the *Shari'ah* Supervisory Council of Amana Takāful PLC has compiled *Fatwas* they found as solutions of practical problems faced in Sri Lanka. This situation indicates a certain degree of developments are found in this regard.

6.2.2.2 Business Developments

The Sri Lankan Takāful industry is developing rapidly with a fully fledged Takāful (Amana Takāful PLC) company and a Takāful window (HNB Assurance Takāful) is in operation at present. Many conventional insurance companies are in the process of establishing Takāful windows in their respective companies. In gross written premium and market share in the insurance industry of Sri Lanka, Amana Takāful shows significant development within the period 2002-2012. Family Takāful premium income in 2012 reached 18 times growth than in 2002. At the same time the general Takāful premium reached 35 times growth in 2012. Total assets of Amana Takāful also indicate the clear developments of business. In the seven years between 2006 and 2012, their assets in family Takāful has gone up to 463% of growth. Meanwhile, their assets in general Takāful reached growth of 457%.

Financial growth is a noteworthy indicator of the development of a company or an industry. The Takāful industry of Sri Lanka shows significant growth statistics shown in the financial statements and analysis done by the insurance regulator, Insurance Board Sri Lanka officially. Revenue, gross written premium, net profit or loss, assets, employees and branches of Amana Takāful between the period of 2007-2013 clearly indicate growth of the industry. Revenue 318%, total gross written premium 231%, total assets 356%, number of employees 2% and number of branches 4% growth is shown within this period. Regarding net profit or loss, the business recorded losses until 2011, from 2012 onwards it recorded a profit. In 2013 growth was 14% higher than the previous year.

Product development is also an indication of growth of any company including insurance companies. The Takāful industry of Sri Lanka witnessed a noteworthy increase

in products. At the inception of Takāful insurance, only 6 products were provided by Amana Takāful PLC. At the moment, there are more than 60 products under two main categories, namely general Takāful and family Takāful. There is a very important development notable here that naming of Takāful products. At the beginning Amana Takāful named the products in English. In the recent past, they used to name them in Sinhala language, the mother tongue of majority people of Sri Lanka. This is not only to attract them and to reveal that Takāful insurance is for all but also to move ahead in the development path.

The rapid growth of number of customers is a good indication that a particular company grows progressively. The customer base in the Sri Lankan Takāful industry is strong and progressive. In 2001 there were substantial numbers of customers in general Takāful of Amana Takāful. But in family Takāful the number ranged between 2000-3000 customers. At present there are about 40-50 thousand clients. 10,489 family Takāful (life) certificates were issued in 2013 alone. This situation indicates that there is a rapid improvement in Takāful customer base.

Creating a section for education, training and research, practicing bancatakāful, introducing CSR programmes and establishing Takāful Window in conventional insurance companies are some significant indicators of development.

6.2.3 Challenges of Takāful in Sri Lanka

The Takāful industry of Sri Lanka witnesses a clear-cut development process. In contrast, it faces numerous challenges internally and externally. In this study, it is found that the following are the main challenges for the Takāful industry of Sri Lanka.

Regulatory challenges are more serious in this regard. The IBSL applies conventional regulatory criteria and product definitions in authorising Islamic insurance institutions. Yet these institutions differentiate themselves from their conventional peers in that they house so-called *Sharī'ah* advisory council. Lack of an Act or regulations separate for Takāful creates serious problems in practice.

Lack of public awareness is a main challenge for the industry. Generally, Muslims are still unaware about insurance, particularly about Takāful as an alternative due to lack of awareness and some misconceptions on insurance / Takāful concepts and practices. Non-Muslims, although they have awareness on conventional insurance, are still reluctant to participate in Takāful due to religious involvement. They think Takāful is for Muslims only.

Shortage of *Sharī'ah* experts and trained workforce is another big challenge for Takāful industry in Sri Lanka. At present there are courses, examinations, trainers and practical training for conventional insurance in Sri Lanka, not nothing of the like for the Takāful industry. There are over 200 Arabic colleges in the island; even a single college does not offer a course / programme for Takāful. In this juncture, the Takāful industry of Sri Lanka is facing challenge in getting right people.

In Sri Lank, there are giant conventional insurance companies rich in assets, customers, products, investments, regulatory and government support, experience, proficiency and other facilities. Operating without or lacking those elements, Takāful companies of Sri Lanka face a big challenge. They have to offer competitive products/services in terms of price, quality of coverage and delivery time.

Investment related issues are another notable challenge for the Sri Lankan Takāful industry. According to the regulation they have to follow, every insurance / Takāful company must invest certain percentage of the premium they collect from the customers, in treasury bills. They have to invest it following the government's investment guidelines. They have given some leverage for the sake of Takāful. But there is investment restriction in *Sharī'ah* compliant investment avenues.

There are also marketing related challenges. They have to introduce and explain an unfamiliar concept to mostly non-Muslims. Price is also a challenge. Due to the investment restriction, their income is low. Eventually, their price will go up. Due to the same reason, they cannot spend huge amount of money for promotions. The commission and other facilities given to the Takāful agents also have some considerable issues.

6.3 Suggestions

In this section, we put forward some suggestions to develop the Takāful industry in Sri Lanka and to overcome its challenges efficiently and effectively. Some of these suggestions were expressed by the respective respondents.

6.3.1 Legal Framework for Takāful

There is lot of differences between the conventional and Islamic policies. Even the definition of word “premium” is different. In terms of Act, we have to change some parts of the Act. *Sharī'ah* scholars can study which parts of the Act should be amended. Legal experts should participate in this and brainstorm how best to address the legal

changes necessary for the industry.⁶²⁸ We can insist IBSL issue separate investment guidelines for Takāful companies.

6.3.2 An Educational Institution for Takāful

The Takāful industry of Sri Lanka needs an institution to disseminate Takāful matters in an organised manner. It can be a centre for Takāful to educate the public, Takāful agents, brokers and practitioners. All Takāful companies and window operators must get together to have an institution with a common pool. This institution can work in drafting common guideline, rules and regulation for all Takāful companies and window operators, publishing Takāful related books, journals and leaflets, conducting courses on Takāful, training the trainers, training the working staff of Takāful companies, conducting exams, conducting workshops and seminars for government school students and for Arabic college students. Establishing an institution like this will be a solution for several problems such as lack of awareness, lack of training and misconception of Takāful insurance. Mohideen,⁶²⁹ former chairman, Ceylinco Takāful Ltd., emphasised this idea.

6.3.3 Books and Journals in Local Languages

In terms of Takāful education for all, standard books must be written by experts in three languages, English, Sinhala and Tamil.⁶³⁰ It is better to get consultation from the subject oriented experts in several fields together such as *Sharī'ah*, finance, accountancy, banking, insurance and commerce. The books must be written completely on all aspects

⁶²⁸ Muath, M.B.M., Head of Finance and Corporate Strategy, First Global Group, Colombo, in the interview held on 26th August 2013

⁶²⁹ Mohideen, S.A.H., Former Chairman, Ceylinco Takāful Ltd., in the interview held on 22nd August 2013.

⁶³⁰ *Ibid*, in the interview held on 22nd August 2013

of Takāful. The writers should be independent. Likewise, several journals or journal articles should be published in three languages to educate the intellectuals and to provide opportunity for scholars and researchers to come up their new research and research findings. It can be done by conducting research symposiums on the theme of Takāful and compile researches in proceedings. A wealthy man or a group of rich people or *Zakāh* federation come forward to fund these programmes and contribute for Takāful education.⁶³¹

6.3.4 Increase of Competitors

At the inception of Amana Takāful there was no such thing called the Islamic financial industry. They started targeting Muslims on faith basis. But today in Sri Lanka there is separate industry called Islamic financial industry. All the conventional banks, have either they started or in the process of starting Islamic windows. Three years ago, deposit base was less than 1 or 2 billion. Today there is 30 or 40 billion deposit base if we take Islamic finance units operating in the banks.⁶³² Having a competition is helping for the industry.⁶³³

Another thing is this industry should be developed to talk to government or authorities. The effectiveness is high when a non-Muslim organisation talks to the government than a Muslim organisation talks.⁶³⁴ If the other companies open Takāful windows and run it sophisticatedly, it is easy to talk with the government. The leasing company or conventional bank, they have *Ijārah* in their Islamic unit. They started for

⁶³¹ Mihlar, A.M., Head of Social Welfare and Counselling, Zahira College, Colombo, in the interview held on 20th August 2013

⁶³² Hifly Huzair, Manager, HNB Assurance Takāful, in the interview held on 24th August 2013

⁶³³ *Ibid*, in the interview held on 24th August 2013

⁶³⁴ Murshid Mulaffar, Secretary of *Sharī'ah* Advisory Council and In-house Advisor, Amana Takāful, in the interview held on 19th August 2013

the purpose to give Takāful cover for the *Ijārah*. It is a big business for them. So, there is a big requirement.

There are some allegations against *Halāl, Jam'iyathul 'Ulama* and Islamic institutions. They cannot put forward the same allegation to the Islamic banks, because non-Muslims are doing Islamic banking. They cannot fight with the giant companies like LOLC, Peoples' Bank, Bank of Ceylon and Commercial Bank.⁶³⁵

If the Takāful industry of Sri Lanka can enhance the customer care and establish more companies, then there will be growth and competition within them. In that situation, they will reduce their benefits and more customers will enter this system. If there are 10,000 clients for the current Takāful company, after commencement of another Takāful company there will be 20,000 for them and another 5,000 or 10,000 clients for the new company.⁶³⁶

6.3.5 Inclusion of Takāful in Formal Education and *Madrasah* Curriculum

A major challenge is shortcomings in knowledge within the industry. If we can eliminate this ignorance, it will promote the industry and encourage good financial and social practices.⁶³⁷ Takāful related subjects are not included in any syllabus of formal education or the madrasah syllabus. Awareness campaigns are therefore necessary.⁶³⁸

⁶³⁵ Murshid Mulaffar, Secretary of *Sharī'ah* Advisory Council and In-house Advisor, Amana Takāful, in the interview held on 19th August 2013

⁶³⁶ Faiz, M.I.A., Chairman, Omega Steels (Pvt.) Ltd., Anuradhapura and a customer, Amana Takāful, in the interview held on 17th August 2013

⁶³⁷ Mihlar, A.M., Head of Social Welfare and Counselling, Zahira College, Colombo, in the interview held on 20th August 2013

⁶³⁸ Mafahir, M.M.M., Takāful Agent, Amana Takaful, in the interview held on 17th August 2013

In Sri Lanka, the first challenge faced by the *Sharī'ah* advisory council is it from 'Ulamas. They said Takāful is a renaming of insurance. The *Sharī'ah* advisory council went to some areas to clarify this system. After their explanation, people wanted to know about this model.⁶³⁹ Awareness programmes for the Arabic college students should be done. The *Sharī'ah* advisory council did some for the 'Ulamas and compiled a book on Takāful.

6.3.6 Establishment of Propaganda Unit

Takāful is a new concept for Sri Lankans. The people who go to Islamic banks or to Takāful company, feel as they go to conventional companies. They do not differentiate between them. There is no any mechanism to explain this system.⁶⁴⁰

If the Takāful industry can promote Takāful by not emphasising on religious aspects of Islam, through TV channels, newspapers, seminars, conferences by presenting research papers – the educated people will recommend it for the common mass. Conducting seminars, workshops, and briefing sessions for religious leaders, members of trade associations, traders, teachers, professionals, government officials, members of women associations, mosque trustee board members and media personnel indicating that Takāful insurance is a good system will benefit the society. It is good to educate the high-ranking people than the ordinary human being. If the operators can convince the finance minister of its benefits, it is easier to attract non-Muslims.⁶⁴¹

⁶³⁹ Mubarak, M.M.A., Chairman, *Sharī'ah* Advisory Council, Amana Takāful, in the interview held on 19th August 2013

⁶⁴⁰ Mansoor, M.A.M., Director, Mishkath Institute for Islamic Research, Akurana, in the interview held on 16th August 2013

⁶⁴¹ Nafees, S.M.M., Senior Lecturer, Dept. of Islamic Studies, South Eastern University of Sri Lanka, Oluvil, Sri Lanka, in the interview held on 9th July 2013

As per the government statistics, Muslims are 10% of the population. They cannot attract 90% of people based on faith. They can do it based on value. They have to forward our value propositions. They have to explain their concept and create awareness.⁶⁴²

A company's website should contain educational materials to explain Takāful concepts, *Shari'ah* compliance, their products and customer services in a manner that is easily understood by the public. By educating their customers in an honest way, they earn their trust.

6.3.7 Establishment of Research and Development Unit

In the Islamic bank as well as in Takāful, there should be a unit for research and development. Intellectuals and researches should be there to look into current market, market trend, investment avenues, trustful personals, *Shari'ah* issues and other related matters.⁶⁴³ The main hindrance is generating funds and investing in profitable vehicles. The research and development unit will come up with plans and projects and it will function to identify suitable ways to generate fund and to evaluate the investment avenues.

⁶⁴² Muath, M.B.M., Head of Finance and Corporate Strategy, First Global Group, Colombo, in the interview held on 26th August 2013

⁶⁴³ Mansoor, M.A.M., Director, *Mishkāth* Institute for Islamic Research, Akurana, in the interview held on 16th August 2013

6.3.8 Intellectual and Spiritual Training

Intellectuals and common people expect this industry should be built up on *Īmān* and *Akhlāq*.⁶⁴⁴ All officers in all level should have Islamic conscious.⁶⁴⁵ Beside providing education on Takāful related subjects, spiritual as well as moral training should be given to them. The human capital is a challenge here. To recruit non-Muslims to this industry, they have to make themselves cater to this environment with their dress code and their behaviour.⁶⁴⁶ Generally, there is lack of Islamic values among the officers, Takāful agents/brokers. They should be social minded, helpful, caring customers.⁶⁴⁷

Knowledge and spiritual training for the operators, managers and agents is essential. For instance: when the son of King Faisal decided to start Islamic bank in Sudan, he took steps to offer one year training for all officers. After that training, the company was started. If the both side training were there, the officers will work by fearing Allah.⁶⁴⁸ The company environment should be surrounded with Islamic values, manners, and attitude. It may be attractive to the non-Muslims to know Islamic ethics and behaviour.

⁶⁴⁴ Atham Bawa, S.H., President, Kandy District *Jam'iyathul 'Ulama* and Vice-President, All Ceylon *Jam'iyathul 'Ulama*, in the interview held on 28th August 2013

⁶⁴⁵ Mubarak, M.M.A., Chairman, *Sharī'ah* Advisory Council, Amana Takāful, in the interview held on 19th August 2013

⁶⁴⁶ Fazal Gaffoor, CEO, Amana Takāful PLC, in the interview held on 19th August 2013

⁶⁴⁷ Mahroof, AJM, Sales Executive, Amana Takāful PLC, Kurunegala, in the interview held on 26th August 2013

⁶⁴⁸ Mansoor, M.A.M., Director, *Mishkāth* Institute for Islamic Research, Akurana, in the interview held on 16th August 2013

6.3.9 Plan to Produce *Shari'ah* Scholars, Experts in Takāful

Currently, Muslims of Sri Lanka do not have expertise or qualified persons in the field of Takāful.⁶⁴⁹ There is a big vacuum.⁶⁵⁰ There is a trend that appointing a *Shari'ah* board member as customary practice. They do not appoint a *Shari'ah* scholar properly paying money, but they appoint him as an external body, consult him once a month or once in three month sor he will be an in-house officer merely for name sake. When the branches increase, he cannot do all works alone. In this situation, the officers who work there perform the role of *Shari'ah* advisor. Indeed the *Shari'ah* advisor should audit each and every paper and be satisfied with *Shari'ah* compliance. In the future, steps should be taken to develop *Shari'ah* scholars.⁶⁵¹

Takāful companies have to improve the following areas:

- *Shari'ah* advisory expertise: Currently, there are only a small number of scholars with expertise in Takāful. The industry should encourage young scholars to acquire the technical insurance knowledge and to be able to advise and to solve the *Shari'ah* compliance problems facing Takāful.
- Academic Qualification: Till now, most of the technicians and executives working in the Takāful companies have a conventional background. To promote Takāful, we have to educate new graduates on Takāful principles and practices.

⁶⁴⁹ Hifly Huzair, Manager, HNB Assurance Takāful, in the interview held on 24th August 2013, Murshid Mulaffar, Secretary of *Shari'ah* Advisory Council and In-house Advisor, Amana Takāful, in the interview held on 19th August 2013 and Mansoor, M.A.M., Director, Mishkath Institute for Islamic Research, Akurana, in the interview held on 16th August 2013

⁶⁵⁰ Imthiyaz, A.W.M., Legal Advisor, Amana Takāful PLC, Colombo, in the interview held on 24th August 2013

⁶⁵¹ Mihlar, A.M., Head of Social Welfare and Counselling, Zahira College, Colombo, in the interview held on 20th August 2013

- Professional Certification: There is a need for specific modules/programmes on Takāful. We have to add to the existing certification (CPI, ACII, FCII, CPA, etc) modules on Takāful for the candidates who intend to or already work for a Takāful company.⁶⁵²

Covering all these area, we have to bring out a plan to produce *Sharī'ah* scholars and experts in Takāful. They should have knowledge of the Sri Lankan legal system, *Sharī'ah*, and Takāful. There are possibilities to utilise *Sharī'ah* scholars who have passed through traditional Arabic colleges and got the university education locally or overseas. And also, it can requested All Ceylon *Jam'iyathul 'Ulamā* to send their Islamic finance panel to undergo an in-depth *Sharī'ah* and insurance related subject training.

Those who have desire and ability to learn like university lecturers, lecturers of Jamiah Naleemiah and Arabic colleges, do not have economic facilities to continue their studies. The *Bait al Māl* or/and *Baith al Zakāh* can provide sponsorship to educate them.

6.3.10 An apex body for *Sharī'ah* Supervision

Sharī'ah governance and supervision are essential segments of Islamic financial institutions. Any IFI cannot operate without *Sharī'ah* supervision. Shortage of suitably qualified *Sharī'ah* scholars and the potential conflicts of interest arising from scholars serving on multiple *Sharī'ah* boards are the main problems in this regard. Beside of making plans to create qualified, abled *Sharī'ah* scholars in Takāful, a plan should be there to form an apex body for all Islamic financial institutions for *Sharī'ah* governance. With that apex body, many problems related to *Sharī'ah* supervision can be solved.⁶⁵³

⁶⁵² Abouzaid, C. (2007). Takāful Market: The Challenges of the Fast Growing Industry, p. 72

⁶⁵³ Muath, M.B.M., Head of Finance and Corporate Strategy, First Global Group, Colombo, in the interview held on 26th August 2013

6.3.11 Generalising the Takāful Brand

Sri Lanka is a multi-ethnic, multi-religious, multicultural country. 90% of the population are non-Muslims. Conceptually, Takāful is not only for Muslims. It is for everyone. Anyone can get a policy from a Takāful company or can operate a Takāful company within the stipulated system. Based on the above briefing, the Sri Lankan Takāful industry should take necessary steps to generalising Takāful insurance system and its operations. In implementing generalising process, the following steps to be taken for the better results: size & capacity of Takāful operators should be increased at par with conventional peers. Cultivating an image among the Sri Lankan “Takāful from Sri Lankan, for Sri Lankan and by Sri Lankan”. Greater customer awareness and higher-level customer service should be assured. More fully fledged and Window operations should be established. New Takāful products and alternative distribution channels should be discovered. Widespread market range and reach is advanced. Broad range of *Shari’ah* compliant investment avenues should be identified. Local and international collaboration should be launched. And sufficient trained human resources should be recruited. The following figure (6.1) summarises the matters we discussed.



Figure 6.1: Generalising Takāful Brand

6.3.12 Introducing New Products

Sri Lanka has a huge potentiality after its 30 year civil war. Presently, it is on the correct path in the developing process. It has mega infrastructure projects that are going on. For example: Southern and Katunayake express are established. Northern and Colombo-Kandy express ways are under construction. Millions of vehicles will use these high ways. Government has signed an agreement with the government of China to start a mega port city project in Colombo. And there are shopping malls and few new things will come in. several harbors and airports are built or renovated. These are opportunities to introduce new and sophisticated Takāful products in the field of motor, import, export,

business, marine, and aviation. The new products should not be for Sri Lankans only, but for the outsiders those who are coming/visiting Sri Lanka, for a shorter period.⁶⁵⁴ Furthermore, there is need for Takāful products for university students, job cuts, farmers and business people. We can also concentrate on micro Takāful products.

6.4 Conclusion

Takāful, an Islamic alternative for conventional insurance was initiated in 1999 in Sri Lanka and has developed a certain extent. There was a need to look in to how far this development reached and what were the challenges for it. Hence, this study was planned to assess the developments and challenges of Takāful in Sri Lanka and focused on providing practical solutions and suggestions to develop this industry even further and facing the challenges positively.

The scope of this research focused on the jurisprudential developments and business developments. To collect the qualitative data, two primary methodologies were used. Focus group interviewees were selected purposively. The interview was held with 42 persons, Takāful operators including members of the *Sharī'ah* advisory council (12 persons), *Sharī'ah* scholars including intellectuals (10 persons) and Takāful customers (20 persons). The second is content analysis from the secondary data, books, research journals, websites, databases, government studies, reports, research papers from seminars, company documents, other institutional publications and subject relevant literature are used for this purpose.

⁶⁵⁴ Muath, M.B.M., Head of Finance and Corporate Strategy, First Global Group, Colombo, in the interview held on 26th August 2013

Chapter one was concerned with introductory part of the study. It dealt with the outline of the research including background and overview, statement of the problem, research questions, scope, objectives, significance, methodology, tools, procedure of the study, analysis of the data, literature review and outline of the chapters.

Chapter two focused on the research site and its regulatory framework. In this juncture, a brief introduction was given on Sri Lankan history, its political, economic and social setup. Furthermore, it dealt with the regulatory framework of insurance / Takāful operating in Sri Lanka.

The third chapter was designed to provide an in-depth theoretical framework of Takāful. It contained sufficient information on every domain of Takāful including its definition, history, importance and significance, developments of Takāful, spread and growth, policies/products, models, contracts, Takāful windows, retakāful, bancatakāful and investment. It gave enough consideration on challenges of Takāful also.

Chapter four described the developments of Takāful in Sri Lanka emphasising on Takāful companies of Sri Lanka and their developments in the jurisprudential and business perspectives. Takāful models and Takāful standards were discussed in the jurisprudential developments. And growth, products, investments, participants, staff, branches, *retakāful*, bancatakāful, education, training and research and Takāful Window were described in the segment of business developments.

Chapter five was dedicated to deal with the challenges of Takāful in Sri Lanka. It dealt with the lack of public awareness, lack of expertise and trained staff, regulatory

challenges, conventional insurance companies, investment oriented challenges, marketing challenges, retakāful related challenges and other challenges.

The last chapter was divided into three main parts. The first part described the research findings, second deliberated the suggestions for further developments and for facing challengers and the third part was allocated for conclusion.

Figure 6.2 discloses the exclusive summary of the thesis.

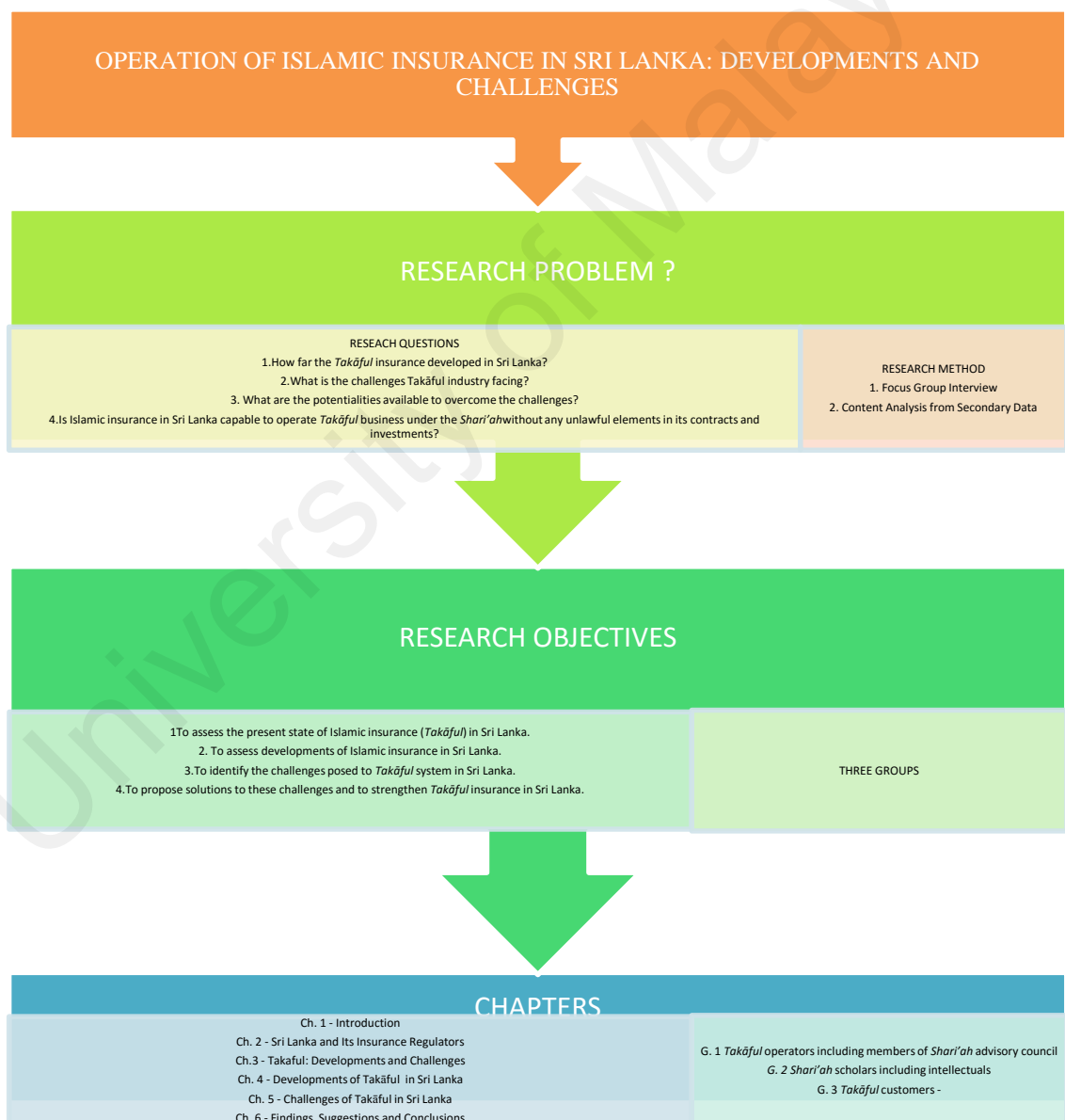


Figure 6.2: Outline of Thesis

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APPENDIX A: Interview Plan

Title: Operation of Islamic Insurance in Sri Lanka: Developments and Challenges

The Research Questions:

1. What is the present situation of Islamic insurance in Sri Lanka?
2. How far has *Takāful* insurance developed in Sri Lanka?
3. What are the challenges facing the *Takāful* industry?
4. What are the options available to overcome the challenges?

Objectives of the Study:

5. To assess the present state of Islamic insurance in Sri Lanka.
6. To assess developments of Islamic insurance in Sri Lanka.
7. To identify challenges faced by the *Takāful* industry in Sri Lanka.
8. To propose solutions to these challenges and to strengthen *Takāful* insurance in Sri Lanka.

Questions for *Takāful* Operators

Code	Question	Objective
RQ1 ⁶⁵⁵ /I ⁶⁵⁶ /TKO ⁶⁵⁷ /IQ1 ⁶⁵⁸	What are the targets and goals of Islamic insurance in Sri Lanka?	OBJ1 ⁶⁵⁹
RQ1/I/TKO/IQ2	What are the short term and long term targets?	OBJ1
RQ1/I/TKO/IQ3	What are the measures you have taken to achieve them?	OBJ1
RQ1/I/TKO/IQ4	Are there any obstacles to achieve them?	OBJ1/OBJ3
RQ1/I/TKO/IQ5	What is the model you use to operate <i>Takāful</i> insurance?	OBJ1/OBJ2
RQ1/I/TKO/IQ6	Do you think that this model suits to Sri Lanka?	OBJ1

⁶⁵⁵ Research Question Number

⁶⁵⁶ Interview

⁶⁵⁷ *Takāful* Operator

⁶⁵⁸ Interview Question, Serial Number

⁶⁵⁹ Objective Number

Code	Question	Objective
RQ1/I/TKO/IQ7	What are the standards you follow? (AAOIFI ⁶⁶⁰ or IFSB ⁶⁶¹ or IFRS ⁶⁶² or ...)	OBJ1/OBJ2
RQ2/I/TKO/IQ1	Do you have any jurisprudential developments in your operational history?	OBJ2
RQ2/I/TKO/IQ2	Have you achieved any significant developments in business?	OBJ2
RQ2/I/TKO/IQ3	Do you think that <i>Takāful</i> industry can compete with conventional insurance industry in Sri Lanka?	OBJ2
RQ2/I/TKO/IQ4	Where do you invest the contributions of participants?	OBJ1/OBJ3
RQ2/I/TKO/IQ5	Where do you make your <i>retakaful</i> ?	OBJ1/OBJ3
RQ3/I/TKO/IQ4	Do you face any challenges?	OBJ3
RQ3/I/TKO/IQ5	Do you face any challenges due to the lack of awareness?	OBJ3/OBJ4
RQ3/I/TKO/IQ6	Do you face any challenges from non-Muslim participants?	OBJ3/OBJ4
RQ3/I/TKO/IQ7	What are the challenges you face regarding regulation/governance issue?	OBJ2/OBJ4
RQ3/I/TKO/IQ8	What are the challenges you face in investing the <i>Takāful</i> funds?	OBJ3/OBJ4
RQ3/I/TKO/IQ9	Do you have sufficient technical experts who learned and experienced in <i>Shari'ah</i> and technical matters?	OBJ3/OBJ4
RQ3/I/TKO/IQ10	Do you face challenges from conventional insurance companies?	OBJ3
RQ3/I/TKO/IQ11	What are the challenges you face in operating <i>Takāful</i> business practically?	OBJ3/OBJ4
RQ4/I/TKO/IQ1	What is your stance in non-Muslim participation in <i>Takāful</i> ?	OBJ1/OBJ3
RQ4/I/TKO/IQ2	What are the steps you have taken to attract non-Muslim participants?	OBJ1/OBJ4
RQ4/I/TKO/IQ3	Do you think <i>Takāful</i> is potential to overcome the challenges?	OBJ4
RQ4/I/TKO/IQ4	Are you confident that your operations are <i>Shari'ah</i> compliant?	OBJ1/OBJ4

⁶⁶⁰ AAOIFI – Accounting and Auditing Organizations for Islamic Financial Institutions – Bahrain

⁶⁶¹ IFSB – Islamic Financial Services Board - Malaysia

⁶⁶² IFRS - International Financial Reporting Standards (conventional)

Questions for *Shari'ah* Advisors

Code	Question	Objective
RQ1/I/SHA ⁶⁶³ /IQ1	What are the targets and goals of Islamic insurance in Sri Lanka?	OBJ1
RQ1/I/SHA/IQ2	Are there any obstacles to achieve them?	OBJ1/OBJ4
RQ1/I/SHA/IQ3	Are you satisfied with the <i>Takāful</i> model adopted by the company?	OBJ1/OBJ2
RQ1/I/SHA/IQ4	Do you think that this model is most appropriate to <i>Shari'ah</i> and Sri Lankan Society?	OBJ4
RQ1/I/SHA/IQ5	Do you approve the standards which are used by the company?	OBJ1/OBJ4
RQ2/I/SHA/IQ1	Do you have any idea to develop this industry in Sri Lanka?	OBJ2/OBJ4
RQ2/I/SHA/IQ2	Are you satisfied in investing process of <i>Takāful</i> company?	OBJ2/OBJ3
RQ2/I/SHA/IQ3	What is your opinion in retakaful in the particular retakaful companies?	OBJ3
RQ2/I/SHA/IQ4	What is your opinion in non-Muslim participation in <i>Takāful</i> ?	OBJ2/OBJ3
RQ3/I/SHA/IQ1	In your opinion, what are the challenges the <i>Takāful</i> industry faces in Sri Lanka?	OBJ3
RQ3/I/SHA/IQ2	In your opinion, what are the challenges the <i>Takāful</i> industry faces in Sri Lanka?	OBJ3
RQ3/I/SHA/IQ3	Do you face any challenges regarding implementation of <i>Shari'ah</i> rules?	OBJ3
RQ3/I/SHA/IQ4	What are the practical challenges the <i>Takāful</i> industry faces in Sri Lanka?	OBJ3
RQ3/I/SHA/IQ5	Do you face any challenges from a particular <i>Takāful</i> company?	OBJ3
RQ3/I/SHA/IQ6	Do we have sufficient <i>Shari'ah</i> experts with appropriate experience in Sri Lanka?	OBJ3/OBJ4
RQ4/I/SHA/IQ1	What is your opinion on potentiality of <i>Takāful</i> to overcome its challenges in Sri Lanka?	OBJ4
RQ4/I/SHA/IQ2	Do you suggest any plan to overcome the challenges?	OBJ4

⁶⁶³ *Shari'ah* Advisor

Questions for *Shari'ah* Scholars

Code	Question	Objective
RQ1/I/SHS ⁶⁶⁴ /IQ1	Is it permissible to make arrangements to attract non-Muslim customers?	OBJ2/OBJ3
RQ2/I/SHS/IQ1	Does increase of non-Muslim participants affect the <i>Takāful</i> company?	OBJ2/OBJ3
RQ3/I/SHS/IQ1	In your view, what are the challenges the <i>Takāful</i> industry faces in Sri Lanka?	OBJ3
RQ3/I/SHS/IQ2	Do you know any challenges in practicing <i>Shari'ah</i> rules in <i>Takāful</i> business in Sri Lanka?	OBJ3
RQ3/I/SHS/IQ3	Do we have <i>Shari'ah</i> experts with sound knowledge and experience in Sri Lanka?	OBJ3
RQ4/I/SHS/IQ1	Do you think <i>Takāful</i> is potential to overcome its challenges in Sri Lanka?	OBJ4
RQ4/I/SHS/IQ2	What are your suggestions to overcome the challenges of <i>Takāful</i> in Sri Lanka?	OBJ4

Questions for Intellectuals

Code	Question	Objective
RQ1/I/INT ⁶⁶⁵ /IQ1	What do you think about insurance generally?	OBJ1
RQ1/I/INT/IQ2	What is your opinion on <i>Takāful</i> insurance?	OBJ1
RQ1/I/INT/IQ3	What do non-Muslims think about <i>Takāful</i> insurance?	OBJ1
RQ3/I/INT/IQ1	What is your view on the challenges the <i>Takāful</i> industry faces in Sri Lanka?	OBJ1/OBJ3
RQ4/I/INT/IQ1	What are your ideas to attract non-Muslim customers?	OBJ4
RQ4/I/INT/IQ2	What are the reasons behind the challenges of <i>Takāful</i> industry in Sri Lanka?	OBJ4
RQ4/I/INT/IQ3	How can the <i>Takāful</i> industry use these challenges in a positive way?	OBJ4
RQ4/I/INT/IQ4	Do you think <i>Takāful</i> is potential to overcome its challenges in Sri Lanka?	OBJ4
RQ4/I/INT/IQ5	What is your opinion to overcome the challenges of <i>Takāful</i> in Sri Lanka?	OBJ4

⁶⁶⁴ *Shari'ah* Scholar

⁶⁶⁵ Intellectual

Questions for Customers

Code	Question	Objective
RQ1/I/CUS ⁶⁶⁶ /IQ1	What is your opinion on <i>Takāful</i> insurance?	OBJ1/OBJ4
RQ1/I/CUS/IQ2	Are there any differences between conventional insurance and <i>Takāful</i> ?	OBJ1
RQ1/I/CUS/IQ3	Are you free from fear of your contributions to the company?	OBJ1
RQ1/I/CUS/IQ4	Do you know where does the company invest your contributions?	OBJ1/OBJ4
RQ1/I/CUS/IQ5	Do you know where the company retakaful does?	OBJ1
RQ1/I/CUS/IQ6	What are the benefits you get other than your claims?	OBJ1/OBJ2
RQ2/I/CUS/IQ1	Do you get profits for your contributions properly?	OBJ3
RQ2/I/CUS/IQ2	Do you feel comfortable with your claims and services?	OBJ4
RQ4/I/CUS/IQ1	Can you say that the <i>Takāful</i> insurance is the best?	OBJ4

⁶⁶⁶ Takāful Customer

APPENDIX B - List of Interviewees

Takāful Operators:

1. Chief Executive Director/ Amana Takāful - Mr. M. Fazal Gaffoor
2. General Manager/ Operation and Medical/ Amana Takāful - Mr. Zaid Aboobucker
3. Regional Manager / Amana Takāful – Central Region – Mr. NM. Ifthikar
4. Branch Managers / Amana Takāful – Kurunegala Branch – Mr. MMM. Ashik,
Kalmunai Branch – Mr. SMM. Rahman (Manager/Life)
5. Chairman of *Shari'ah* Advisory Council/ Amana Takāful - Moulavi MMA. Mubarak
6. Secretary of *Shari'ah* Advisory Council/ Amana Takāful - Moulavi M. Murshid
Mulaffar
7. Former General Manager of Ceylinco Takāful – Mr. SAH. Mohideen
8. Manager /HNB Assurance Takāful – Mr. Hifly Huzair
9. Broker/Agent – Mr. AJM. Mahroof, Mr. MMM. Mafahir and Mr. MMM. Rinas

Shari'ah Scholars:

1. Vice President of All Ceylon *Jam'iyyatul 'Ulama* - Ash-Sheikh S.H. Ātham
Bawa (President/Ampara District)
2. Vice President of All Ceylon *Jamiyyathul 'Ulama* – Moulavi MHM. Burhan
(President/Kandy District)
3. *Moulavi* AS. Hibathullah of Kurunegala

Intellectuals:

1. One person related to Takāful industry - *As sheikh* AWM. Imthiyaz (Legal advisor)
2. Two persons related to conventional insurance industry – Mr. MA. Saleemdeen, Mr.
SHM. Nizar
3. One person from public Service – *As sheikh* AM. Mihlar of Zahira College,

4. One academic working in university – Dr. SMM. Nafees (Senior Lecturer, South Eastern University of Sri Lanka)
5. Two personals related to Educational Institutions – *As Sheikh* M.A.M. Mansoor, Director, *Mishkāth* Institute for Islamic Research and MMM. Muath, First Global groups

Customers:

Twenty Customers of Takāful insurance were chose from selected areas of Takāful company available – Kandy (07), Kurunegala (05) and Kalmunai (08). Among them 07 personals from Public Sector, 08 from Business field, 02 entrepreneurs and 03 personals from private sector.

Kandy	Kurunegala	Kalmunai
Mr. MBM. Fawaz	Mr. AMM. Mursaleen	Mr.MA. Sakaf
Mr. MFM. Razlan	Mr. MFM. Fazir	Mr. MHM. Nairoos
Mr. MIA. Faiz	Mr. TM. Irfan	Mr. SL. Badurdeen
As Sheikh B. Tharik Ali	Mr. SH. Najeem	As Sheikh ARM. Ashraf
Mr. MZM. Riyas	Mr. HA. Khan	Mr. MI. Ubaidur Rahman
Mr. MRM. Wazeer		Mr. Uvais Mohideen Bawa
Mr. SAM. Thasleem		Mr. AM. Farees
		Mr. SM. Azwer

Areas covered:

Colombo: The commercial capital of Sri Lanka (Western Province) where the head offices all Insurance and Takāful companies situated. 08 personals were interviewed in this area.

Kalmunai: This area is situated in the Eastern part of Sri Lanka where the Muslims live predominantly. 11 personals were interviewed in the area.

Kandy: It is the capital city of the Central province of Sri Lanka. 15 interviewees were involved.

Kurunegala: A main city of North Western province of Sri Lanka. 08 personals were interviewed.

Appendix C: List of Products of Amana Takāful PLC

1. All Risk Takāful
2. Aviation Takāful
3. Boiler & Pressure Vessels Takāful
4. Burglary
5. Business Interruption
6. Contractor's All Risk
7. Credit Risk Takāful
8. Crystalline
9. DeerganYou
10. Deterioration of Stock in Cold Storage
11. Electronic Equipment Takāful
12. Erection All Risk
13. Fidelity Guarantee
14. Fire Takāful
15. Fishing Boat Takāful
16. Freight Forwarders Liability
17. Glass Insurance
18. Goods in Transit
19. Guarantee Bonds
20. House Owner's Comprehensive Takāful
21. Laptop All Risk
22. Liability Takāful
23. Loss of Profits (Machinery Takāful)
24. Machinery Breakdown

25. Marine Cargo
26. Marine Hull
27. Mobiler All Risk
28. Money Takāful
29. Motor Takāful
30. Neon Sign Takāful
31. Personal Accident Benefit
32. Personal Liability
33. Plant & Machinery All risks Takāful
34. Plate Glass Takāful
35. Products Liability
36. Professional Indemnity
37. Public Liability
38. Shop Comprehensive
39. Surgical & Hospitalization Takāful
40. Suwasiri
41. Takāful Adhyapana
42. Takāful Business Cover
43. Takāful Easy Marine
44. Takāful Group Life
45. Takāful Hale & Hearty
46. Takāful Hale & Hearty Young Minds
47. Takāful KruthaGuna
48. Takāful My Home
49. Takāful Navodaya
50. Takāful Platinum

51. Takāful Prosper
52. Takāful Protection & Indemnity
53. Takāful Retirement Plan
54. Takāful Surakshitha
55. Takāful Total Drive Comprehensive
56. Takāful Total Drive Third Party
57. Title Takāful
58. Travel Takāful
59. Workmen's Compensation
60. Workshop Liability
61. Worldwide Travel Takāful (Travel Pal)

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