

# **Academe Appraisal of Islamic Critique on Conventional Insurance and the Role of Islamic Insurance (Takaful)**

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## **Abstract**

The concept of Insurance evolves from mutual help in times of need and distress, rather than a Business proposition for profit making as practiced today. In Conventional Insurance, the relation between the insurer and the insured is that of buyer and seller, this is not the case with Islamic Insurance (Takaful), Takaful promotes shared responsibilities, solidarity, mutual assistance and cooperation to protect participants (policyholders) against risks misfortune in accordance with policy. The paper examines and scrutinize Islamic critiques on Conventional Insurance, also the research focuses Islamic Insurance policy which is Takaful based on concept of mutual help and co-operation in providing material security for the insured against an occurrence of unexpected peril or lose, the paper find that Conventional insurance is prohibited for Muslims as agreed upon by most contemporary scholars. The methodology used by this paper is generally qualitative relevant data source from Quran and Hadith, journal publications and so forth, the paper recommend that both Muslims and non-Muslim should be aware that Islamic Insurance complies with Islamic Law and avoid prohibited activities.

**Keyword:** Conventional, Legality, Islamic Insurance (Takaful).

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## **Introduction**

In the name of Allah, the most beneficent the most Merciful. All praise is due to Almighty Allah we praise on Him and seek his help and forgiveness, we seek refuge in Allah from the evil of our own self and our sinful deeds, whom ever Allah guide there are not to misguide him and whom go to astray, there not guide him. I bear witness that there is no God of worship except Allah, and I bear witness that Prophet Muhammad (SAW) His Messenger and servant, Allah May bestow and Blessings upon the Messenger and pure Family as well as all the Noble Companions and those who fallow them in righteousness until the Day of Reckoning.

From buying a home to operating a business, twenty-first century society mandates procuring Insurance. However, there are prohibited elements in Insurance that create the need to introduce an alternative to Western Insurance products. Muslim Scholars advocate Takaful as the best substitute.

Both Takaful and Conventional insurance policies work on the same basic system; the pooling of funds to manage the risk of a group of people. However, there are major differences between the two systems. The most obvious is that Takaful adheres strictly to the Islamic principles upon which it was developed.<sup>i</sup>

The objective of this paper is to explore and highlight how Islamic critiques on Conventional Insurance, Takaful can be an alternative to insurance; thereby benefitting society. Also this paper discusses differences between Takaful and Conventional Insurance. Additionally, The critiques by scholars on Conventional Insurance.

The origin of the concept of Insurance is traceable to the business practices adopted by Italian merchants in the beginning of the 14th century which was similar in structure to modern day Insurance practices. The risks associated with shipping of goods facilitated the evolution of risk Insurance policy. Overtime, the popularity of the practice increased. The practice spread to London which was the then hub of maritime Business. The practice essentially involved Merchants entering into agreement to bear the risk inherent in movement of goods. They also resolved trade related disputes according to the custom of their trade. In 1601 on the instigation of merchants, a chamber of assurance was established by statute to regulate insurance business.<sup>ii</sup>

By mid-18th century, Lord Mansfield introduced reforms which culminated in the common law court applying principles derived from the trade customs of merchants and the traditional common law concepts to resolve matters arising from contracts of insurance. With time, the jurisdiction of the court over insurance matters became firmly entrenched. Marine insurance was the pioneer type of insurance and was predominantly operated at a coffee shop belonging to a man called Lloyd. The practice was that any merchant desiring insurance cover would circulate a piece of paper requesting for cover from any of the persons present. The slip of paper provided information about the ship, the voyage plan, details of the cargo and other particulars they deemed necessary. Willing insurers, initialed the slip. When the aggregate target of the insurance required was underwritten, the contract of insurance was deemed to have been perfected. Over the years Lloyd expanded his business and became the global leader in the issuance of insurance policies especially marine insurance policies. The principles adopted in the course of carrying on marine insurance business have influenced other classes of insurance business including fire insurance and personal accident insurance.<sup>iii</sup>

During the pre-colonial era in Nigeria, indigenous people, tribes and communities practiced some form of insurance. Age grades, tribal associations, communal associations and social clubs in return for members paying some form of dues were assured of the support of other members in times of adversity like failed harvest, deaths ailment etc. Levies were imposed and donations sourced to ensure that such members were protected and provided for adequately. Aggregate communal resources were often utilized to bail out members suffering from calamities. This could be held analogous to insurance practices.<sup>iv</sup>

After the Nigerian Independence in 1960, Nigerian insurance companies were registered to operate in Nigeria and grew from one to twenty-five by 1970, there was in existence in Nigeria over one

hundred and fifty insurance companies. The expanding insurance business started providing a wide range of services including product liability insurance, workmen compensation insurance, goods in transit insurance as well as bond, credit and suretyship insurance.<sup>v</sup>

Insurance has been described as a transaction in which the insurer (the insurance company) for a certain consideration (premium) promises to reimburse (indemnify) the insured or render services in the case of certain accidental losses suffered during the subsistence of the agreement.

### **Types of Insurance**

Insurance transactions are as varied as the vicissitudes sought to be insured against. They include

- (a) Automobile or Motor insurance: it is the commonest form of motor insurance. It may cover legal liability claims against the driver and loss or damage to the vehicle
- (b) Health Insurance: It covers medical bills incurred as a result of illness, injury or accident which impacts on the health of the insured.
- (c) Life insurance: Provides for family members and other named beneficiaries to make up for loss of the insured's income
- (d) Fire insurance: it is usually taken to indemnify the insured against loss of property due to fire outbreak.
- (e) Credit insurance: It provides payment for some or all loans back where the borrower either due to unemployment, disability or death is unable to pay.
- (f) Annuities: Annuities and pensions provides for the payment of benefit for life. It insures against the possibility that a retiree will outlive his financial resources.<sup>vi</sup>

### **Meaning of Islamic Insurance (Takaful)**

Takaful is an Arabic word derived from the word *Kafala*. Basically, Takaful refers to an arrangement of joint guarantee by a group of participants based on mutual-agreement to indemnify one another in the event of a defined loss.<sup>vii</sup>

Investopedia website defines Takaful as Islamic insurance which entails members contributing money into a pool of funds to be utilized in mutually guaranteeing members against loss or damage.<sup>viii</sup>

Takaful concept is based on *Shariah* provisions aimed at fulfilling the responsibility of individuals in cooperating to protect one another.<sup>ix</sup>

Takaful otherwise called Islamic insurance is an arrangement whereby a group of persons undertake to manage injuries resulting from a specified risk to which all members of the group are vulnerable. To facilitate this arrangement, members of the group donate in form of contribution to establish a common insurance fund as a legal entity with independent financial liability to be utilized in indemnifying participants in the event of injury subject to certain stipulated conditions. In carrying out this task, the fund is managed by a group of the participants or a joint stock company that manages the fund for a specific fee.<sup>x</sup>

Similarly, the National Insurance Commission of Nigeria (NAICOM) defines

Takaful-insurance as a form of insurance that is compatible with *Shariah* provisions based on the principles of *Tabarru* (donation/contribution) and *Ta'awun* (cooperation).<sup>xi</sup>

### Legality of Islamic Insurance (Takaful)

The idea of Islamic insurance or *Takaful* is based on the concept of *Al-Aqilah*, which had been practiced by the ancient Arab tribes before 570CE. During that time, if any member of a tribe was killed by a member of another tribe, the heir of the victim will be paid an amount of blood money as compensation by the close relatives of the killer. Therefore, the central idea of *Al-Aqilah* is to make money contributions to pay for the compensation. *Al-Aqilah* concept is similar to the indemnity in today's insurance practices as it is a kind of financial protection for their heirs against an unexpected death of the victim. The practices of *Al-Aqilah* then obtained recognition in Islamic law based upon the approval of the Holy Prophet Muhammad (PBUH). This can be seen in one of his judgements against a woman from the tribe of *Huzail*.<sup>xii</sup>

*“Narrated by Abu Hurairah(r): he said that once two women from Huzail clashed when one of them hit the other with a stone which killed her and her fetus in the victim's womb. The heirs of the victim brought an action to the court of the Holy Prophet (s.a.w), who gave the verdict that the compensation of the fetus to be a male or female slave while the compensation for the victim woman is a blood money (Diyat) to be paid by the Aqilah (the paternal relatives) of the killer.”*  
(Sahih al- Bukhari)

Islamic insurance policy which is *Takaful* is based on concept of mutual help and co-operation in providing material security for the insured against an occurrence of an unexpected peril or loss.

Few references in the Quran and Hadith has emphasized on mutual co-operation. Quranic Verse: *“...And help one another in righteousness and piety, but do not help one another in evil deeds and enmity”* (Al Maidah(3):2)

*In Hadith: “Narrated by Abu Hurairah(r), the Holy Prophet (s.a.w) said: “Whosoever removes a worldly hardship from a believer Allah (s.w.t) will remove from him one of the hardships in the hereafter...”* (Sahih Muslim, as compiled in al-Nawawi, Forty Hadith).

### Principles of Islamic Insurance Products.

In Islam, the practice of insurance emerged from the practices of early Arab tribes in the form of the doctrine of *al-Aqila*, which had been approved by the Holy Prophet (peace be upon him). Later, insurance was gradually practiced by all and then made compulsory in a few cases.

In today's world, numerous companies selling *Sharī'ah*-based insurance are being established in many Islamic countries including Brunei, Indonesia, Malaysia, Iran, Saudi Arabia, Sudan, Luxembourg and Qatar.

Under the Islamic principles, the sources of insurance law can be categorised into general sources and specific sources. The general sources include the *Qur'ān*, the *Sunnah*, *Ijma'a*, *Qiyās*, *Ijtihad*, *Istihsan*, *Masalah al-Mursalah*, *'Urf* and *Fiqh*, while the specific sources include the general

contract principles, the laws relating to liability, the principles of mutual cooperation, humanitarian law and *al-Mudharabah* and the concept of welfare. Therefore, all aspects of an insurance policy must comply with the *Sharī'ah* compliant principles to be deemed valid and enforceable under the Islamic law.

The most commonly used models of Islamic insurance are the *Mudharabah* model, the *Wakalah* model and the *Mudharabah-Wakalah* model. Some of the other models are the *Ta'awuni* model and the *Waqf* model. These models are covered in detail in chapter 7 of this course.

Even though insurance practice continues to grow around the world, Islamic scholars are still divided with regard to the validity of insurance policy. One group of scholars agrees with the concept and practice of all insurance, while another group of scholars agrees with the concept and practice of only general insurance, not life insurance. A third group of scholars completely opposes the idea and practice of insurance arguing that insurance is totally against the *Sharī'ah* principles.

Therefore, a new model for Islamic insurance practice has been proposed with numerous recommendations. The model stresses that all activities of insurance practice must be based on profit sharing principles because it justifies the principle of mutual welfare of the parties involved.

On completing this chapter, you will be able to:

- Describe the stages of Islamic insurance development ranging from the customary to the contemporary Islamic societies,
- Explain the proposed model for Islamic insurance contracts that operates based on the *Mudharabah* financing technique,
- Describe the limitations imposed by the *Sharī'ah* to purify transactions,
- Describe the fundamental characteristics based on which insurance contracts are held valid,
- Describe the rationale behind the practice of an insurance contract,
- Describe the generic sources of insurance law under Islamic principles and
- Describe the specific sources of insurance law under Islamic principles.

### **Development of *Takaful***

In modern-day contexts, the first *takaful* company - Islamic Insurance Company of Sudan - was founded in Sudan by the Faisal Islamic Bank in January, 1979 (Anwar, 2008). The Bank's *Shariah* Supervisory Board approved this endeavour, and in January 1979, the Islamic Insurance Company was established as a public company under the *Companies Act, 1925* (Sudan).

In Malaysia, the Islamic Insurance Company was established as a private limited company. The Malaysian government constitutes a task force on the establishment of Islamic insurance in Malaysia. The task force report indicates that *takaful* has enormous benefits to Malaysia. Consequently, the Malaysian government promulgated the *Takaful Act, 1984*, which regulates *takaful* in Malaysia (Ali, 2008).

In 1985, the Council of Islamic Scholars in Mecca approved *takaful* as a *Shari'ah*-approved alternative to the conventional insurance system. This led to mutual *takaful* companies being established in different Muslim countries, including Dubai, Bahrain, and Malaysia (Anwar, 2008).

Presently, Malaysia has the most mature *takaful* operating alongside conventional banking and insurance (Anwar, 2008).

In Nigeria, African Alliance Insurance Company Limited, the oldest specialist life assurance, introduced *takaful* into the market in 2003. Subsequently, Niger Insurance Plc and Cornerstone Insurance Plc also introduced *takaful* products in Nigeria. *Takaful Operational Guideline* (2013) establishes *Shariah* Supervisory Board for operations of *takaful* in Nigeria. This is appropriate as the establishment of a *Shariah* Supervisory Board is a prerequisite for *takaful* operation (Ali 2008).

### Categories of Insurance

There are basically two types of Insurance:

- Conventional Insurance
- Islamic Insurance (Takaful).

Conventional insurance can be defined as an agreement whereby an insurer undertakes (in return for the agreed premium) to pay a policyholder an amount of money (or its equivalent) on the occurrence of a specified event. The specified event must have some element of uncertainty about it.<sup>xiii</sup>

The uncertainty may either lie in the fact that although the event is bound to happen in the ordinary course of nature, the timing of its occurrence is uncertain.<sup>xiv</sup>

Insurance in general sense is transferring the risk from a party be it an individual, an organization or company to insurance company for a certain payment of premium. It is the most practical method of handling a major pure risk. (Hendon Redzuan, RubayahYakod, Mohamad Abdul Hamid, 2006).

Through insurance system, the insurance company is also known as the insurer, while the insurance buyer is called the insured or the policyholder. An insured is required to pay premium at the inception of the contract. Premium is the price of insurance protection and service rendered from the insurer. In the event of a loss occurring, insurance company is obligated to pay compensation as specified under the insurance policy. The compensation paid out to the insured or his beneficiaries is called insurance benefit. (Zuriah Abdul Rahman & Hendon Redzuan, 2009).

Insurance is an economic institution founding on the pillar principle of reciprocity, formed for the purpose of establishing a general fund. The need arises when unexpected risk occurred, which the probability of such risk to happen can be reasonably calculated. In financial term, insurance defined as redistributing the cost of unexpected losses. (IBFIM, 2011).<sup>xv</sup>

- Islamic Insurance (Takaful).

Takaful Is the Islamic alternative to conventional insurance. It is defined as “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” (Bank Negara Malaysia, 1984).

There are three aspects of mutuality represented in Takaful; mutual help, mutual responsibility and mutual protection from losses. It is an arrangement in which participants contribute regularly to a common pool of funds with the intention of jointly guaranteeing each other. When a participant enters a Takaful scheme, it does not only involve seeking protection for personal loss, but it also includes cooperating with other participants and contributing to help those in need. Thus, Takaful ta’awuni or Islamic cooperative insurance is not a contract of buying and selling where one party sells protection and another buys the service for a certain price.<sup>xvi</sup>

### **Difference between Takaful and Conventional Insurance**

Even though *Takaful* and insurance have common objective of reducing a financial burden arising from any disaster or accidental loss, there are still differences in the underlying concepts between both contracts. As being discussed earlier, *Takaful* is based on the idea of solidarity, cooperation, and joint guarantee in the face of any disaster losses. It is an agreement among a group of persons who agree to jointly share responsibility of loss or damage that may inflict upon any of them; out of the fund they donate collectively but in conventional setup loss is indemnified by the insurance company according to the terms and condition of the policy (Maysami et al., 1997).

*Takaful* is based on the concept of mutual indemnity in providing protection and compensation to the participants who suffered from perils or hazards (Muhammad 2013).

On the other hand, conventional insurance is a device for the reduction of risk of one party, called the insured, through the transfer of particular risks to another party, called the insurer, who offers a restoration, at least in part, of economic losses suffered by the insured (Pfeffer, 1956). In insurance, the risk is transferred from the insured to the insurer.<sup>xvii</sup>

The other main difference in Insurance it is not bound to *Shariah* principles as *Takaful*. In *Takaful*, all the activities should not have the elements of *riba’*, *gharar* and *maysir*. However, according to Muhammad Nejatullah Siddiqi (1985), the three elements (*riba’*, *gharar* and *maysir*) present in conventional insurance that do not comply with *Shariah*:

Takaful has considerably grown during the last three decades. Most of the literature emphasizes on Takaful concept and its difference with conventional insurance is frequently discussed. Following are the conceptual differences between Takaful and the conventional insurance.

#### **i. Joint Guarantee/Ta’awun**

Takaful is conceptually defined as an Islamic financial protection system which involves a joint guarantee scheme in providing possible indemnity or contingency but conventional insurance is based on compensation of loss in exchange of premium which is paid by insured (Billah, 2003). Takaful operation is based on the concepts of *Ta’awun* (mutual help or cooperation) solidarity, trusteeship, and brotherhood but conventional Insurance is based on to take material gain on behalf of other (Yusuf, 1996; Azman 1997; Maysami and Kwon 1999; Billah 2003).

In Islamic society Takaful system worked on the basis of *Ta'awun* and *Tabarru*. Participants mutually agree to help and guarantee each other by collecting contribution from individual, for the sake of mutual cooperation. Literally, insurance is worked on risk transferring process under which one protects themselves on behalf of others (Maysami and Kwon 1999; Umar and Dawood 2000; Billah 2003; El-Gamal 2001).

The main purpose of Takaful under the Islamic system is to bring equity to all parties involved, and the objective of the contract is to help the policyholders through bad times. Profit earnings is not the main goal, while sharing any profit generated incidentally is acceptable but in conventional system business is started with the aim to earn profit (Maysami and Kwon 1999).

Where Almighty Allah (SWT) says;

*“Help one another in al-Birr and in al-Taqwa (virtue, righteousness and piety) but do not help one another in sin and transgression” (Al-ma’ida, 2)*

Also, the Prophet Muhammad (SAW) says

*“Whoever removes a worldly hardship from a believer, Allah will remove from him one of the hardships of the hereafter. Whosoever alleviate the needy person, Allah will alleviate from him in the world and the next” (Translation of Sahih Muslim Book 32, No 6250).<sup>xviii</sup>*

From the above light of the Qur’an verse and Hadith of prophet Muhammad (SAW) we came to recognized the clearly difference between the two and point of critiques by Islamic scholars on conventional insurance, why because under conventional insurance, the tendency of indulging into hardship and lack of God consciousness (Taqwa) will be responsible.

## **ii. Social Solidarity/ Shared Responsibility**

Takaful, the Islamic alternative to conventional insurance is based on the idea of social solidarity, cooperation and joint indemnification of losses of the members. It is an agreement among a group of persons who agree to jointly share responsibility of loss or damage that may inflict upon any of them; out of the fund they donate collectively but in conventional setup loss is indemnified by the insurance company according to the terms and condition of the policy (Maysami et al., 1997).

Takaful insurance has grown not only as an innovative financial instrument, but also on religious consideration (Maysami and Kwon, 1999). The contract of *Takaful* provides solidarity in respect of any tragedy in human life and loss to business or property (Ayub, 2003).

The Islamic model of insurance policy is based on the fundamental principle of mutual cooperation and solidarity, as ordained by Allah (SWT) mentioned to this effect in the Holy Quran (Maysami and Kwon, 1999). But for conventional insurance there is no any religious boundaries and the purpose of insurance is to protect risk-averse from suffering the full cost of those actions on the part of nature which affect them unfavorably.

### iii. Concept of Aaqilah:

Takaful is not a modern concept in Islamic commercial law. The current jurists acknowledge that the foundation of shared liability or Takaful was laid down in the system of 'Aaqilah', which was an arrangement of mutual help or indemnification customary in some tribes at the time of the Holy Prophet (S.A.W). In case of any natural disaster, every person used to contribute something until the loss was indemnified. Takaful is basically based on the idea of Aaqilah for the payment of blood money wherein payment was made by the whole tribe. Islam accepted this principle of mutual compensation and joint liability (Billah, 1998).

### iv. Risk Distribution:

The conceptual difference between Takaful and Conventional Insurance is that risk in Takaful 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 (Umar and Dawood 2000).

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 (Yusuf, 1996; Maysami and Kwon 1999; Billah 2003b). 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 (Spence and Zeckhauser,1971).

## Critique by Islamic Scholars on Conventional Insurance

In 1985, the Grand Council of Islamic Scholars Majmaual-fiqh Academy of the organization of Islamic Conference issued a resolution on Insurance as follows;

### 1. Al-Gharar

This refers to 'unknown' or 'uncertain' factors in a conventional Insurance Contract. In conventional Insurance policyholders are not informed on how Profits are distributed and in what the funds are invested in. In a *Takaful* operation, this is based on the *Mudharabah* concept, the distribution of profits to the operators and the participants are clearly outlined in the contract.<sup>xix</sup>

### 2. Cooperative Insurance

The alternative contract which respects the principle of Islamic transactions is the cooperative Insurance Contract. It is built on the principle of voluntary contribution and mutual cooperation. The same apply to reinsurance, which should also be built on the same principle of mutual cooperation.<sup>xx</sup>

The Prophet Muhammad (SAW) says;

*“The pace of relationship and feelings of people with faith, between each other, is just like the body; when one of its parts is affected with pain, then the rest of the body will be affected”*. (Narrated by Imam Al-Bukhari and Imam Muslim Book 32).

“On true Muslim (Mu'min) and another true Muslim (Mu'min) are like a building where every part in it strengthens the other” (Narrated by Imam A;-Bukhari and Muslim).

“By my life, which is in Allah’s power, nobody will enter paradise if he does not protect his neighbor in distress” (Narated by Imam Al-Bukhari and Imam Ahmad bn Hambal).

It is also another precise and explicit different between the two and point of critiques since the conventional insurance lack to protect and remove pain from each other which is provided under Shari’ah (Islamic Law) that is why Islamic scholars criticizing its operation and management.

### 3. Al-Maysir

This is the 'gambling' element and is said to derive from the '*Gharar*' element. In conventional insurance the policyholder stands to lose all the premiums paid if the risk does not occur. On the other hand, he stands to get more should a misfortune happen whilst paying a small amount premium. In *Takaful*, even though the risk does not occur, the participant is entitled to get back the contributions that he has paid. Should the risk occur, he will be paid from his premium fund plus the pool of funds from the 'donation' of other participants.<sup>xxi</sup>

### 4. Riba

This refers to the interest factor present in the investment activities of Conventional insurance companies. The policy loan in conventional life insurance is in fact a *riba* based transaction. Islam prohibits any investment activities that are interest based.<sup>xxii</sup>

Daud Bakar (2000) asserts that, *Takaful* is differs from conventional insurance in the sense that the company is not the insurer insuring the participants. The persons participating in the scheme mutually insure one another and this is the very essence of the word *Takafulin* Arabic. The operational framework of conventional insurance is based on “risk assumption” but *Takaful* operate under mutual co-operation basis. It means that, *Takaful* is a scheme or a social program for the collection of funds for the aid of participants in contingent future.<sup>xxiii</sup>

Furthermore, the conceptual difference between *Takaful* and conventional insurance is that the risk in *Takaful* 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 (Omar and Dawood, 2000).<sup>xxiv</sup>

The operator in *Takaful* acts as fund manager. They will manage the fund contributes by the participants and therefore the operator is not undertaking risk. The risk is however, distributed among the participants who agreed to jointly assume the risk (Yusof, 1996).<sup>xxv</sup>

In insurance, the initial capital is contributed by the shareholders meanwhile in *Takaful*, the fund is supplied by *rabbul mal* (policyholders). Investment of the premium in insurance is conducted by insurer without involvement of policyholders. Meanwhile in *Takaful*, the business activities

are being conducted either through *mudharabah* model (profit sharing) or *wakalah* model (agent-principal relationship). In *Takaful* operations, the capital is invested in investment funds that must *Shariah* compliant but investment of insurance capital not subject to *Shariah* compliant.<sup>xxvi</sup>

*Takaful* is not mainly a profit-making activity, but it most focused on the issue of the community in helping the others. The operations of *Takaful* is emphasised on the concept of mutual protection and shared responsibility. Therefore, the society will be exposed to moral values of helping and caring for the *ummah*. Hence, *Takaful* concept is the best way to resolve society needs in facing any risk throughout daily life.<sup>xxvii</sup>

## **5. Investment of Funds**

The distinction between conventional insurance and *Takaful* business is more visible with respect to investment of funds. There is no hard and fast rule from investment point of view in insurance setup. Conventional insurers may invest in such type of assets that are strictly forbidden by the *Shariah* such as alcohol, gambling or pork are haram (Al Janahi and Weir, 2005; Gait and Worthington, 2008). While *Takaful* companies invest funds in interest free avenues and with the concept of Halal (Ayub, 2003).

## **6. Nature of Contract**

By their nature, *Takaful* companies face additional risks as compared to conventional insurance. Conventional insurance companies invest large amount in fixed income securities on their balance sheet in order to minimize the risks and the variability associated with the equity. But in *Takaful* under *Shariah* law, interest is forbidden, which rules out the investment in fixed income securities. In conventional insurance the contract is based on the principles of exchange of interest. The relationship is designed in such a way that the insured buys protection by payment of premium, and insurer provides protection against the insured risk. Under Islamic law insurance transaction can not be concluded on this basis of buy and sale contract (Ali, 2006). Under *Takaful* contract every policyholder has the right to know how their money is used, how the surrender value is calculated, and *Takaful* 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-halal goods but in conventional insurance policyholder have no right to know about this (Arbouna, 2000). 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 (Billah, 1997).<sup>xxviii</sup>

## **Conclusion:**

This paper examines on Islamic critiques with conventional insurance, also this paper discusses the difference between *Takaful* and conventional insurance, *Takaful* promotes cooperative risk-sharing and mutual assistance. Conventional insurances are unacceptable in *Shariah* due to the presence of three elements in Conventional insurance is against *Shariah*. These elements are; Riba-leading and borrowing fund/investment at fixed interest; Gharar uncertainty resulting from deception or lack of clear terms and conditions; and Maisir- speculation or Gambling, *Takaful* is being practiced now as an alternative to the Conventional insurance. The progress of *Takaful*, however, defends on a healthy growth of Islamic Banking.

### Recommendations:

Muslim should not use conventional insurance for their life protection plan, from *Shari'ah* perspective, here are the reasons why; in managing the wealth, people have been using insurance to manage the risk. Life does not always go as smoothly as we want it to be. Also both Muslim and non-Muslim aware that Islamic insurance complies with Islamic law and avoid prohibited activities.

Muslim scholars should endeavor to learn people more about the Islamic Insurance and avoid conventional insurance.

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