



Takaful: An Alternative Approach to Insurance

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Takaful: An Alternative Approach to Insurance

Overview

Takaful came into existence in the backdrop of an increased demand for a financial system that brings the concept of insurance in line with Islamic values and the fundamental principles of Islamic finance. Many individuals, particularly in Muslim majority countries like Pakistan, Malaysia, Bahrain, the Kingdom of Saudi Arabia, and the United Arab Emirates, face limited acceptability to formal insurance due to concerns around *Riba* (interest), *Gharar* (uncertainty and ambiguity in contracts), *Maysir* (speculative risk), and other factors.

Takaful insurance emerged as a key component of Shari'ah-compliant financial services that aims to cater to individual's insurance needs, while also conforming to Islamic beliefs and norms. Since the establishment of the first Shari'ah-compliant insurer in Sudan in 1979, Takaful has been operating on a cooperative model much like mutual insurance, but the similarities between the two financial systems are only on the surface. A deeper analysis reveals differences in the two models that set Takaful apart from other conventional forms of insurance in terms of risk sharing and fairness. The very essence of the Islamic form of insurance is the participation of members in the contribution of funds into a common pool, where resources are collectively available to support members facing specified adverse events or losses.


This paper aims to analyze Takaful as an ethical form of insurance, its brief history, challenges, comparison of the financial reporting framework under conventional insurance with various Islamic insurance models, and the potential growth in the regions it's currently operating in, while highlighting the growth potential in the international markets as an ethical game-changer in the insurance industry.

The paper also analyzes the issues within the Takaful framework that makes standardization the biggest challenge in its widespread implementation, exploring the regulatory frameworks in countries like the Kingdom of Saudi Arabia (KSA), the United Arab Emirates (UAE), Bahrain, Pakistan, and Malaysia, highlighting the role of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in standardization, and delving into actuarial considerations in Takaful, including assumption setting and product pricing/reserving.

In addition, the paper aims to analyze the impact of Takaful on society, including its contributions to financial stability, risk mitigation, and the empowerment of individuals and businesses. Despite the complications in implementation, policymakers recognize the potential of Takaful in promoting financial inclusion. This multifaceted analysis aims to bridge the gap between conventional insurance and Takaful, providing insights for Western markets to efficiently adopt the Takaful framework to compete against their conventional counterparts.


Most importantly, the paper also proposes a viable solution for markets where the Takaful framework is not regulated, enabling conventional insurers to offer Takaful products and addressing operational aspects.

The Takaful business is set for significant development and growth between 2023 and 2028. It brings a significant and ethical shift in insurance, aligning with Shari'ah principles and emphasizing community welfare. Takaful's focus on ethical practices ensures fair insurance choices. This innovative approach promises a financially secure and compassionate future for everyone involved.



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Section 1: Understanding Takaful

1.1 WHAT IS TAKAFUL

Takaful finds its roots in the provisions of the Holy Quran (5:2), "Cooperate with one another in goodness and righteousness" that, in essence, represents an innovative and alternative approach to insurance, with the emphasis on shared accountability and mutual support that is reflected and deeply rooted in Islamic finance principles. Derived from the Arabic word "Kafalah," which signifies mutual guarantee or joint responsibility or benefit, Takaful can best be explained as a group of contributing participants entering into an agreement to pool investments and mutually guaranteeing each other in the event of a loss.

Tabbaru (contribution) and *Ta'awun* (cooperation) are the fundamentals of Takaful on which the whole framework has been established, thereby upholding the values of cooperation, solidarity, and social responsibility that are deep-rooted in the Islamic injunctions pertaining to financial matters (Zulkifli et al., 2012). In contrast to conventional insurance, which may involve practices that conflict with Islamic principles, Takaful aligns insurance operations with Shari'ah-compliant guidelines, emphasizing fairness, transparency, and inclusivity.

To put it simply, Takaful is a system of mutual cooperation amongst policyholders whereby they reimburse each other in the event of a loss out of the contribution pool or fund to which they have agreed to contribute a regular amount, managed by a Takaful operator (Omar and Dawood, 2000).

The Central Bank of Bahrain (CBB) defines Takaful as,

"The concept of Takaful involves the payment of contributions that are wholly or partially donated to form an insurance portfolio. The pooled resources are then used to pay indemnity when the insured risk occurs. The pooling of donations and assisting those in need through indemnity payments does not contradict Sharia, but is in line with the principles of compensation and shared responsibilities among the community."

While the Security and Exchange Commission of Pakistan (SECP) defines it as,

"Takaful is an Islamic insurance concept which is grounded in Islamic *Mua'malat* (banking transactions), observing the rules and regulations of Islamic law. Takaful is basically a system of Islamic insurance based on the principle of *Ta'awun* (mutual assistance) and *Tabarru* (voluntary contribution), where the risk is shared collectively by the group. It is operated based on shared responsibility, brotherhood, solidarity and mutual cooperation or assistance, which provides for mutual financial security to safeguard participants against a defined risk."

1.2 HISTORICAL PERSPECTIVE

Takaful finds its origins in the early Islamic era in 622 when Muslims of Makkah and Madina established the practice of shared responsibility and mutual assistance to indemnify the members of any loss. This method of insurance came into practice in various forms in the backdrop of a growing need to be insured against the losses one bears in the case of a major financial setback, but conventional methods of insurance were disallowed by the people of faith due to *Al-Gharar* (uncertainty), *Al-Maysir* (Gambling), and *Riba* (Interest) (Al-Amri & Hossain, 2015).

For many years since the practice began in the early Islamic era, members of the Muslim community came together to support one another during times of crisis and loss, forming the foundation of mutual assistance, shared responsibility, and cooperation. The concept, over time, evolved into a formalized Takaful model, deep-rooted in the core Islamic values of equity and brotherhood. The idea of Gharar stresses the aversion of uncertainty in monetary exchanges, while Maysir puts any type of betting or gambling down. Riba strictly goes against the acquiring of interest from monetary exchanges. Considering these standards, the Muslim people looked for a way to defend against gambling that would be in accordance with their strict convictions. The early act of Takaful involved individuals from the community pooling their resources to establish a fund aimed at providing financial assistance to those encountering crises. This practice of mutual aid extended beyond immediate family units, cultivating a feeling of common obligation and brotherhood.

Over time, this casual arrangement of shared responsibility developed into a formalized framework maintaining the possibility that policyholders or participants collectively bear the weight of risks perceived by each individual. The commitments made by individuals are diverted into a typical asset. This asset is then used to give monetary help to those individuals who experience unexpected conditions. Any excess produced from the commitments is shared among the members, ensuring fairness in the framework.

1.3 KEY PRINCIPLES OF TAKAFUL

Structured on the fundamental principles of cooperation, mutual protection, and shared responsibility, a Takaful agreement must eliminate actions of interest (Riba), gambling (Maysir), and uncertainty (Gharar), in line with Islamic values. Each rule reflects the Islamic values of collaboration, decency, and shared responsibility, while being in accordance with the forbiddance of interest and speculative practices. The key principles outlined below help us understand the Takaful framework and its essential traits.

1.3.1 MUTUAL ASSISTANCE (TABARRU)

One of the most rudimentary principles of Takaful is the concept of “Tabarru”, where participants willingly contribute a portion of their premiums into a common pool. This pool serves as a fund to help those who experience losses or face unexpected circumstances, adhering to the Islamic principle of aiding one another during times of difficulty. (Adawiyah and Scott, 2008)

1.3.2 SHARED RISK (MUDARABAH)

Takaful operates on the principles of Mudarabah, establishing a partnership between the participants and the Takaful operator. Participants contribute to the pool with their premiums, while the Takaful operator manages the fund. Any surplus coming out from the pool is equally given back to the participants in the form of surplus sharing, promoting a sense of equity and partnership.

1.3.3 PROHIBITION OF INTEREST (RIBA)

Islamic finance imposes strict prohibition on the payment or acceptance of interest (Riba). This prohibition extends to contributions and distributions within Takaful, ensuring compliance with Shari’ah principles. Transactions in Takaful are structured to be free from any interest-based elements, maintaining compliance with Islamic finance guidelines that prioritize fairness and ethical financial practices.

1.3.4 NO UNCERTAINTY (GHARAR)

Takaful contracts avoid elements of uncertainty and gambling, ensuring that the risks covered are well-defined and explicitly understood by all parties involved.

1.3.5 AVOIDANCE OF SPECULATION (MAYSIR)

Maysir, or speculative practices, are discouraged in Takaful arrangements to ensure that operations are conducted on principles of certainty, transparency, and ethical conduct.

1.4 COMPARISON BETWEEN TAKAFUL AND CONVENTIONAL INSURANCE

A careful study of Takaful and conventional insurance models would reveal various conceptual similarities between the two frameworks. However, the most important and fundamental difference between the two lies in the profit and loss sharing system and the complete eradication of interest from the equation. Another key difference is that Takaful framework cannot be completed without the establishment of a Shari'ah Supervisory Board whose primary responsibility and function is to determine whether a financial transaction or an insurance product is in its very essence compliant to the Shari'ah rules pertaining to Islamic finance. More on this is discussed later in the paper.

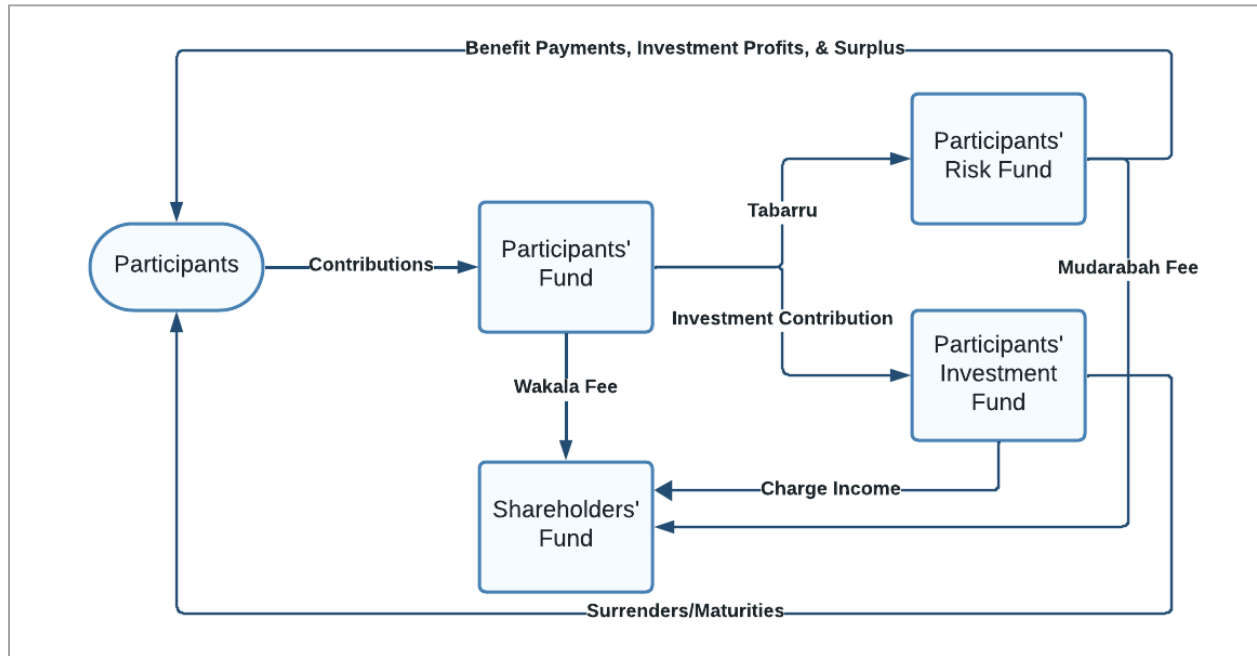
Some of the most important and significant differences between Takaful and conventional insurance are discussed below:

Table 1

COMPARISON BETWEEN TAKAFUL AND CONVENTIONAL INSURANCE

TAKAFUL	CONVENTIONAL INSURANCE
Based on mutual cooperation.	Based entirely on commercial factors.
Devoid of interest (Riba), gambling (Maysir), and uncertainty (Gharar).	Necessary elements of interest, gambling, and uncertainty.
Participants' contributions to the Takaful fund, whether in full or part, helps others in the event of a loss or risk.	Insurance company retains the premium paid by the policyholder in exchange for bearing all expected risks.
Subject to the rules, regulations, and governing laws of the region, as well as a Shari'ah Supervisory Board.	Subject to the rules, regulations, and governing laws of the region.
There is segregation between the Participants' Takaful Fund and the Shareholders' Fund.	Premium paid by the policyholder is considered as income to the company, belonging to the shareholders.
Surplus in the Participants' Takaful Fund is shared among Participants only, and the returns on investment are distributed between the participants and the shareholders based on the principles of Mudarabah.	All surpluses and profits go directly to the shareholders.
In the event of a deficit within the Participants' Takaful Fund, Takaful Operator provides for an interest free loan (Qard-e-Hasn) to the participants.	In case of deficit, the conventional insurance company covers the risks.
Investment activities carried out by the Takaful Operator are Shari'ah compliant.	Investment activities carried out by the conventional insurers may not be Shari'ah compliant.
For reinsurance, Takaful operators go to the Retakaful companies or conventional reinsurers that abide by certain rules of Shari'ah or offer Retakaful through windows.	Conventional insurance companies do not have the obligation to have reinsurance with Shari'ah compliant reinsurers.

Figure 1
CONCEPTUAL UNDERSTANDING OF TAKAFUL BUSINESS



The following table illustrates the terminological differences between Takaful and conventional insurance. These terminological variances highlight Takaful's distinct principles and structures, which differ from the conventional insurance framework.

Table 2
TERMINOLOGICAL DIFFERENCES BETWEEN TAKAFUL AND CONVENTIONAL INSURANCE

CONVENTIONAL	TAKAFUL
Policyholder	Participant
Premium	Contribution
Reinsurance	Retakaful
Claims	Benefits

Moreover, it's worth highlighting that the Wakala Fee, Mudarib Share, and Qard-e-Hasn are Takaful-specific concepts that do not exist under conventional insurance. The later sections of this paper provide details surrounding Takaful-specific concepts, as well as an illustration of financial reporting under various Takaful models.

1.5 TAKAFUL VS. MUTUAL

At first glance, Takaful and mutual seem to operate in a similar way. However, a closer examination of both frameworks reveals notable differences between the two.

In mutual, members are responsible for indemnifying other members in the event of a deficit whereas, in Takaful, the shareholders provide an interest-free loan (or Qard-e-Hasn) to cover the loss, which is later recovered from future surpluses.

Another distinction is capital provision: members contribute capital in mutuals while, in Takaful, the operator supplies it. Additionally, Takaful investments strictly adhere to Shari'ah principles, ensuring compliance with Islamic ethical guidelines.

Moreover, a critical divergence is the presence of a Shari'ah Supervisory Board (SSB) within Takaful operations. This board validates, oversees, and advises on the Shari'ah compliance of products and services, a feature absent in mutual insurance.

1.6 IS TAKAFUL A MUTUAL?

Mutual and Takaful are cooperative insurance programs with a similar core concept: sharing assets and risks among the members/participants to ensure financial security. However, their underlying ideologies, organizational structures, and ethical standards differ significantly.

Takaful is based on the tenets of solidarity, mutual cooperation, and shared responsibility, rooted in Shari'ah (Islamic law) which forbids interest, speculation, and uncertainty. In a Takaful arrangement, participants contribute to a pooled fund (the Takaful fund) to cover specific risks.

Qualified participants can seek compensation from the Takaful fund in case of a loss. Any surplus in the fund may be distributed among participants as dividends or allocated to charitable organizations.

Takaful operators prioritize ethical investment practices investing in Shari'ah-compliant assets. In contrast, mutual insurance operates as a cooperative approach based on mutuality. Policyholders and the insurance company owners collectively bear the risks. Premium payments from policyholders contribute to a common fund, which is used to settle claims. Instead of distributing profits to external shareholders, mutual insurers return gains to policyholders through dividends or reduced premium rates.

Unlike Takaful, mutual insurance, utilized by various organizations worldwide, religious and non-religious alike, does not consistently adhere to specific religious or ethical principles.

The moral and religious adherence is the main distinction between Takaful and mutual insurance. Takaful strictly abides by Islamic law, ensuring all investments and transactions comply with Shari'ah rules. To the contrary, mutual insurance may or may not adhere to religious principles, and its ethical standards can vary based on individual insurers' values.

Another key difference lies in organizational structure. Mutual insurance operates on mutuality, with policyholders acting as owners, while Takaful operates as a cooperative based on the concepts of "Tabarru" (contribution) and "Mudarabah" (profit-sharing).

In summary, both mutual insurance and Takaful embrace cooperative models, yet substantial differences exist in their guiding ideologies, organizational structures, and ethical considerations.

Table 3
DIFFERENCES BETWEEN TAKAFUL AND MUTUAL

TAKAFUL	MUTUAL
<p>Islamic Principles: Takaful is governed by Shari’ah law and is founded on Islamic principles. It abides by moral and ethical standards, refraining from interest-based transactions and investing in ventures that engage in forbidden activities like gambling and/or the sale of alcohol.</p>	<p>Non-Religious: Mutual insurance operates independently of religious ties or stipulations, unrestricted by any specific religious doctrines.</p>
<p>Risk-Sharing Principles: Participants under a Takaful framework are expected to share risks and work together cooperatively. To assist one another in times of need, participants make contributions to a communal pool (Tabarru). The main goal is to protect and support one another financially.</p>	<p>Transfer of Risk: Mutual insurance entails risk transfer, whereby policyholders pay premiums in exchange for the insurer taking on all associated risks. Transferring risk from individuals to the insurance firm is the main goal.</p>
<p>Distribution of Surplus: Any surplus that remains after claims and operating costs have been paid is divided among participants in accordance with predetermined rules. This surplus sharing demonstrates the idea of shared advantages and strengthens the cooperative aspect of Takaful.</p>	<p>Policyholder gains: In mutual insurance, policyholders are regarded as corporate shareholders. Insurance company profits are given to policyholders in the form of dividends or lower premium rates.</p>
<p>Ethical Investments: Takaful investments follow Shari’ah guidelines and concentrate on morally upright and Shari’ah-compliant assets. The investments stay away from interest-bearing products and industries that go against Islamic principles.</p>	<p>Investment Scheme: Mutual insurance companies place their money in a variety of financial products and industries according to the knowledge of their fund managers. Their financial choices are not constrained by any ethical principles.</p>

In conclusion, the comparison between Takaful and mutual insurance reveals their distinct operational norms and fundamental governing principles. Takaful is purposefully crafted to align with Islamic principles, emphasizing ethical financial planning, risk-sharing, and surplus distribution among members. To the contrary, mutual insurance operates with a strong emphasis on the connection between its members. It follows a model where profits earned are shared among members or used to reduce premium rates when needed.

Ultimately, the choice between these two security models hinges on personal convictions, individual values, and the preferred approach to managing risk and finances.

1.7 GENERAL TAKAFUL

General Takaful refers to insurance protection designed to cover losses or damages to properties, assets, or possessions resulting from specified events, typically lasting a year or less. Participants in Takaful contracts

contribute to a fund, and operators manage risks. The contributions form the General Takaful fund, which is invested, and profits are returned to the fund. Two primary types of General Takaful are motor and non-motor.

Motor Takaful covers accidents or damages to personal vehicles. Participants pay premiums for the contract duration, usually a year. Non-motor Takaful includes various schemes like fire, marine cargo, personal accident, burglary, and machinery failure insurance.

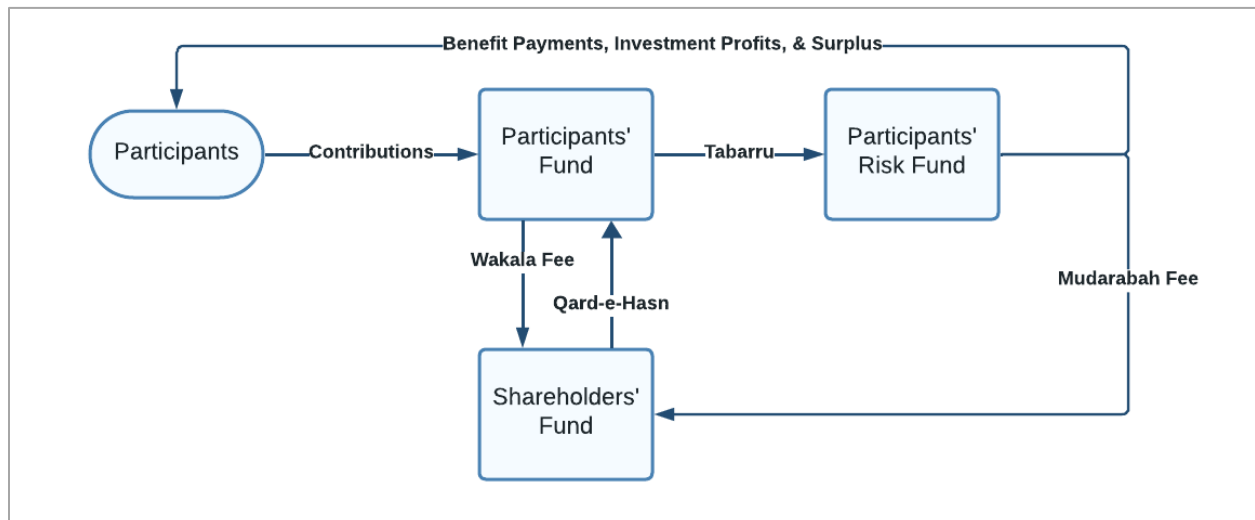
Contributions made, termed as “tabarru,” go into the risk fund to cover participants' potential losses within the specified period. This fund invests in Shari’ah-compliant products, with returns added to it. Surpluses, after settling claims and deducting direct charges (such as Wakala fees), are distributed to participants. If costs exceed the fund, a Qard-e-Hasn (interest-free loan) from the shareholders' fund may be used to cover the shortfall.

1.7.1 EXAMPLES OF PRODUCTS UNDER GENERAL TAKAFUL

- Property Takaful: Protects against damages due to fire, lightning, and explosions, including buildings, inventory, and machinery.
- Marine Takaful: Offers compensation for losses or damages to cargo transported via ships, planes, or roads.
- Motor Takaful: Ensures coverage for vehicle damages resulting from accidents.
- Miscellaneous General Takaful: Tailored coverage designed to meet diverse corporate needs.

Figure 2

THE FUND TRANSFER PROCESS IN GENERAL TAKAFUL



1.8 FAMILY TAKAFUL

Family Takaful encompasses long-term Takaful products extending beyond a year, ranging from 5 to 20 years, such as pension, children's education, and mortgage Takaful plans. These contracts aim to cater to participants' long-term savings and investment needs, as well as provide protection in case of a covered contingency.

Family Takaful plans, structured with or without a savings component, allocate contributions differently. In plans featuring savings, a substantial portion goes to participants' investment funds, earmarked for savings, while a smaller segment, known as the risk premium, feeds into the participants' Takaful fund. Conversely, plans without a savings component direct all contributions to the participants' Takaful fund, designed to cover potential losses during the contract term.

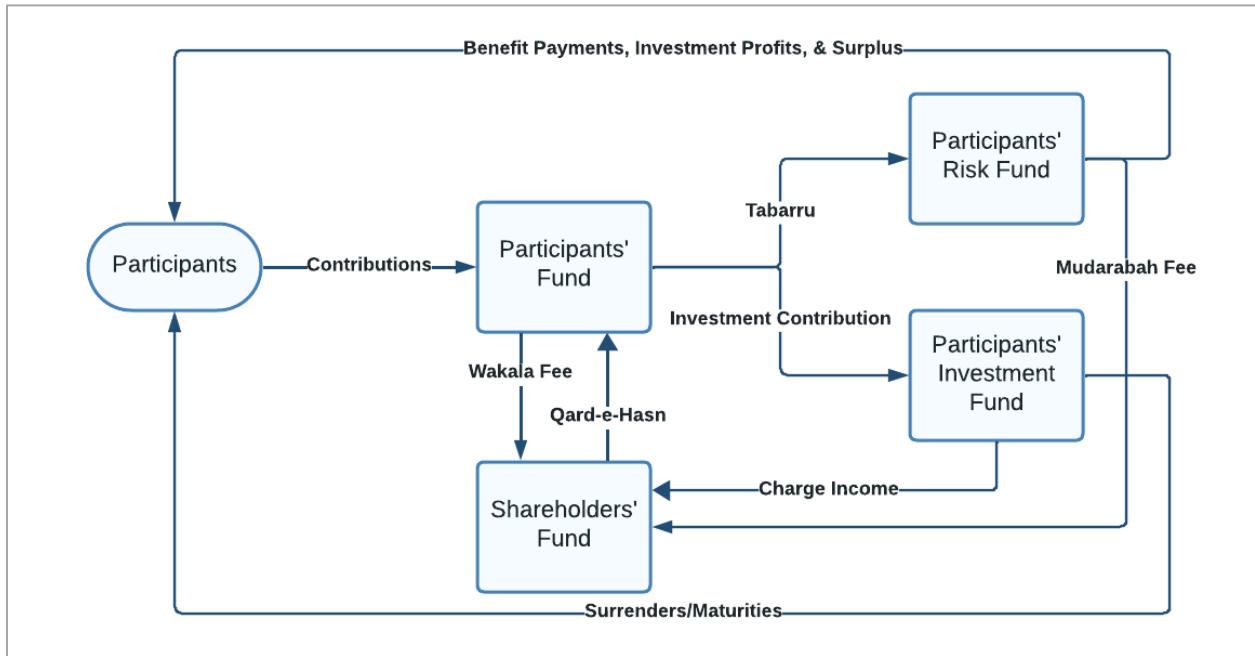
Surpluses within the Takaful fund, which remain after settling claims and deducting charges like Wakala fees, are distributed among participants. However, in cases of deficits, an interest-free loan, termed Qard-e-Hasn, may be drawn from the shareholders' fund to offset shortfalls, which can be recovered from future surpluses.

Both funds engage in Shari'ah-compliant investments, but their expected returns may differ. Investments from the participants' Takaful fund aim to generate additional surpluses within the fund and avoid investment loss, emphasizing liquidity and low risk. Conversely, investments from the participants' investment fund carry the investment risk, which is effectively borne by the participants, offering a choice between conservative, balanced, or aggressive asset classes at the contract's inception.

1.8.1 EXAMPLES OF PRODUCTS UNDER FAMILY TAKAFUL

- Term Life Takaful: Provides a payout if the insured person passes away during the coverage period.
- Whole Life Takaful: Offers lifelong coverage with fixed contribution payments.
- Endowment Takaful: Provides endowment benefits upon maturity or to dependents if the insured person passes away during the endowment period.
- Investment-Linked Takaful: Merges investment and Takaful coverage for families, adhering to Shari'ah-compliant investments.
- Medical Takaful: Covers the costs of inpatient and outpatient care at private hospitals.
- Marriage Plan: Aims to offer financial support for children's marriages.
- Child Education Takaful: Offers financial security for children in case of a parent's passing or permanent disability.

Figure 3
THE FUND TRANSFER PROCESS IN FAMILY TAKAFUL



Section 2: Benefits of Takaful

Some of the key benefits of Takaful are listed below.

2.1 MORAL AND SHARI'AH COMPLIANCE

Takaful operates in accordance with Islamic principles, ensuring transactions are free from interest (Riba), uncertainty (Gharar), and gambling (Maysir). It gives people and organizations a protection choice that lines up with their religious beliefs and values.

2.2 SHARED RESPONSIBILITY

Encouraging shared responsibility among members, Takaful fosters cooperation and support during challenging times. The Tabarru principle motivates individuals to contribute to a common pool, aiding those facing losses.

2.3 BROAD ACCEPTANCE OF TAKAFUL

Takaful encompasses most traditional insurance products, such as health, travel, and motor insurance, while remaining Shari'ah-compliant. Its compatibility with Islamic principles makes it an appealing choice. Despite challenges faced by conventional insurers entering the Takaful market, its wider acceptance extends to diverse audiences, including those in non-Muslim countries. Takaful's ability to embrace conventional insurance products enhances financial protection accessibility.

2.4 EXCESS SHARING

In Takaful, surplus from the pool is shared among members. This surplus sharing model allows members to benefit financially beyond mere loss coverage.

2.5 TRANSPARENCY AND FAIRNESS

Takaful operators are mandated to maintain transparency in their operations and financial transactions. Members gain a clear understanding of how contributions are managed and distributed, fostering trust and fairness within the system.

2.6 CUSTOMIZATION AND FLEXIBILITY

Takaful offers flexibility in designing coverage that aligns with the specific needs of individuals and businesses. Members can tailor their plans to suit their unique circumstances, ensuring appropriate coverage without paying for unnecessary elements.

2.7 STABLE REGULATORY ENVIRONMENT

Many countries with substantial Muslim populations have established robust regulatory frameworks for Takaful, providing legal recognition and support for the industry. This fosters growth and development in both Muslim-majority and non-Muslim-majority countries.

2.8 SOCIAL WELFARE AND CORPORATE SOCIAL RESPONSIBILITY

Takaful aligns with social welfare principles and corporate social responsibility by promoting individual well-being and contributing to societal development. Encouraging mutual assistance and charitable initiatives, Takaful nurtures a culture of social responsibility and compassion.

Section 3: Takaful Framework

3.1 ESTABLISHMENT OF TAKAFUL FRAMEWORK

A framework refers to the structured system designed to outline and guide the operations of a particular objective or service. In the context of Takaful, this encompasses the regulatory infrastructure, industry-wide operational procedures, applicable models, and a set of rules governing Shari'ah supervision and conflict resolution. The framework provides the structure and guidelines necessary for the effective functioning of Takaful operations.

3.1.1 REGULATORY FRAMEWORK FOR TAKAFUL

In the realm of Takaful, a regulatory framework encompasses specific laws, rules, and guidelines established for the functioning of Takaful entities. Each country implements its distinct regulatory framework, either through legislative measures or through private organizations dedicated to overseeing Takaful operations.

International bodies, such as the Islamic Financial Services Board (IFSB), the International Association for Insurance Supervision (IAIS), and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), have formulated standards and guidelines governing Takaful businesses across regions like the Gulf Cooperation Council (GCC) and Asia.

BAHRAIN

Takaful operations in Bahrain are governed by the Central Bank of Bahrain (CBB) through its comprehensive Rulebook, which covers various aspects, including licensing, governance, capital requirements, and financial reporting. Under Article HC-9.2, Takaful and Retakaful operators are mandated to establish a Shari'ah Supervisory Board (SSB) comprised of at least three Shari'ah scholars. This board, in compliance with AAOIFI's Governance Standard No. 1, plays a critical role in advising on all Takaful operations, ensuring adherence to Shari'ah principles, and overseeing product design, claims handling, investments, and management and distribution of participants' surplus.

Chapter 8 of the Rulebook provides detailed guidance on Takaful models and operational requirements. It mandates the use of a Hybrid Model (Article 8.2.1) and requires operators to disclose wakala and mudarabah fees within the Takaful contracts (Article 8.2.2). Section 8.4 addresses Qard-related matters, specifying that investment income generated from assets forming part of the Qard belongs to the participants' fund (Article 8.4.12), and outlines procedures for Qard write-offs after five years (Article 8.4.16). Moreover, Section 8.5 outlines rules for surplus distribution, in compliance with AAOIFI's standards, necessitating recommendations by the actuary and endorsement by both the SSB and the board of directors, with final approval from the CBB (Articles 8.5.1 and 8.5.3).

These regulations underscore the CBB's commitment to ensuring Shari'ah compliance, financial stability, and consumer protection within Bahrain's Takaful industry. By providing clear guidelines and oversight mechanisms, the CBB's Rulebook promotes transparency, accountability, and ethical conduct, fostering a robust and resilient Takaful sector in Bahrain.

MALAYSIA

In Malaysia, the regulatory framework governing Takaful operations is supported by a robust set of legislative and policy documents aimed at ensuring Shari'ah compliance, promoting financial stability, and safeguarding consumer interests within the Islamic insurance sector.

The Central Bank of Malaysia Act 2009 represents a key piece of legislation. Under Part 7 Chapter 1, this act establishes the Shari'ah Advisory Council (SAC), serving as the authoritative body for interpreting Islamic law in financial matters. The SAC issues rulings, provides guidance to Islamic financial institutions, and ensures consistency in Shari'ah interpretations nationwide.

Complementing this legislation, the Islamic Financial Services Act 2013 (IFSA) furnishes a comprehensive regulatory framework for Islamic financial institutions, including Takaful and Retakaful operators. IFSA mandates Shari'ah compliance, with Part 4 Division 1 underscoring the SAC's authority and the imperative to adhere to its rulings. Division 2 mandates the formation of Shari'ah Committees within the Takaful entities.

Further augmenting transparency, consistency and accountability is the policy document on Financial Reporting for Takaful Operators. Article 13.8 of this document mandates disclosure of the Takaful operator's role based on contractual (wakala and/or mudarabah contracts) terms, facilitating clarity among stakeholders.

Similarly, the policy document on Takaful Operational Framework provides detailed guidelines for Takaful operations, covering the establishment of an operational framework that includes policies and procedures governing various aspects of Takaful operations. Notably, Takaful contracts must receive mandatory approval from the Shari'ah Committee. The document also addresses fund establishment, investment management, surplus distribution, and qard provisions. Importantly, the document provides flexibility by allowing Takaful operators to utilize any of the three Takaful models covered under Section 4 of this paper.

Furthermore, the policy document sets forth comprehensive requirements governing various facets of Takaful operations. This includes mandates for the establishment and maintenance of Takaful funds, ensuring that the participants' Takaful funds are separate from the shareholders' funds. In cases where applicable, the document also requires the establishment of a participant's investment fund under the family Takaful fund. Moreover, it stipulates the disclosure of key aspects within the Takaful contract, such as the determination and assessment of wakala and/or mudarabah fees.

Of particular significance within the policy document are the provisions concerning qard and hibah. The framework mandates provisions for repayment, and potential write-off of qard, while allowing the operators to service the participants' funds deficit through hibah, effectively transferring ownership of assets without any consideration.

In summary, the regulatory framework surrounding Takaful operations in Malaysia is characterized by its depth and specificity. Through legislative acts and comprehensive policy documents, the industry benefits from clear guidelines and robust oversight mechanisms. These measures not only enhance transparency, consistency, and accountability, but also provide flexibility for operators to adapt to evolving market needs while upholding the fundamental tenets of Islamic finance.

PAKISTAN

Pakistan's regulatory landscape for Takaful, governed by the Insurance Ordinance 2000, the Insurance Rules 2002, and the Takaful Rules 2005, underscores the nation's commitment to Islamic finance principles. The Securities and Exchange Commission of Pakistan (SECP) oversees these regulations, ensuring adherence to Islamic tenets and governing various aspects of Takaful operations.

Key regulatory measures dictate that the Takaful operators comply with the Takaful Rules 2005 and prioritize them in case of discrepancies. Registration mandates setting up separate entities for Family Takaful and General Takaful operations, with specific capital requirements for each. Additionally, Shari'ah compliance is integral, with a mandatory Shari'ah Board overseeing Takaful operations and product design.

Operational models, such as the Wakala Model or Hybrid Model, are permissible, with mandatory requirements to maintain separate funds for the participants and the shareholders, each adhering to Shari'ah principles.

The determination and assessment of wakala and/or mudarabah fees in family Takaful operations necessitates mandatory approval from the Appointed Actuary while, in general Takaful operations, approval from the Shari'ah Board is requisite. Likewise, the determination and distribution of the participants' surplus must be approved by the Appointed Actuary for family Takaful operations and by the Shari'ah Board for both family and general Takaful operations. Surplus distribution may involve either cash payments or a reduction in future contributions. The Rules also allow surplus being credited to the participants' investment fund in the case of family Takaful contracts.

Pakistan's Takaful regulations signify a commitment to Islamic finance principles, financial stability, and transparency. The establishment of a Central Shari'ah Board by the SECP underscores a proactive approach toward fostering Shari'ah-compliant financial practices. With rigorous oversight and adherence to Islamic principles, Pakistan's Takaful industry thrives as a beacon of ethical and inclusive insurance practices in the global Islamic finance landscape.

KINGDOM OF SAUDI ARABIA (KSA)

In the Kingdom of Saudi Arabia (KSA), Takaful operates on the principles of cooperative insurance, adhering to Shari'ah law, without a specific governing regulation around Takaful. However, the regulatory oversight for cooperative insurers in the KSA is managed by the Insurance Authority, ensuring compliance with various aspects, such as solvency requirements, adequacy of technical provisions, and investment activities conducted by cooperative insurers within the Kingdom.

Saudi Arabia has witnessed remarkable growth in its Islamic financial services business, positioning the country prominently in Islamic finance. The oversight of health insurance providers falls under the purview of the Council of Cooperative Health Insurance (CCHI), while the Insurance Authority regulates insurance and reinsurance firms. Local insurers are required to register as publicly traded joint-stock companies, subject to regulation by the Capital Markets Authority (CMA), while foreign-invested insurers must comply with the Foreign Investment Act and obtain a foreign investment license from the Saudi Arabia General Investment Authority (SAGIA). (Abdullah et. al, 2012)

The regulatory framework for cooperative insurance companies in the Kingdom of Saudi Arabia is governed by the Implementing Regulations of the Cooperative Insurance Companies enacted in 2003. This framework aims to protect policyholders and shareholders, ensure fair competition, and maintain financial stability within the insurance industry. Key provisions include licensing requirements, the mandatory appointment of an actuary, retention and cession of premiums, valuation of assets, and surplus distribution, with 10% of the net surplus allocated to policyholders.

Cooperative insurance and reinsurance companies in the Kingdom are required to maintain a solvency margin to cover potential losses, following a risk-based methodology. Additionally, the Cooperative Insurance Company Control Law of 2021 stipulates that insurance in the Kingdom must be provided by companies operating in accordance with the practice of cooperative insurance and consistent with Shari'ah principles. Investment regulations mandate separate investment policies for policyholders' and shareholders' investments, reflecting differing objectives and targets.

Overall, Saudi Arabia's regulatory framework for cooperative insurance underscores the commitment to Shari'ah compliance, financial stability, and transparency in the insurance industry, reinforcing its position as a leading jurisdiction in Islamic finance and Takaful.

UNITED ARAB EMIRATES (UAE)

In 2014, the United Arab Emirates (UAE) set a milestone by introducing specialized regulations for Takaful within the MENA region. Currently, the insurers and Takaful operators in the UAE are regulated by the Central Bank of the UAE (CBUAE) through distinct financial regulations applicable to insurers and Takaful operators separately. These

regulations encompass a wide range of aspects, including investment activities oversight, adequacy of technical provisions, and solvency requirements for both the company and individual Takaful funds.

The integration of the Insurance Authority into the Central Bank of the UAE, governed by Decretal Federal Law 25/2020, has transformed the insurance industry in the UAE. Given this, insurers, brokers, and related businesses fall under the regulatory purview of the Central Bank. However, free zone insurers and Takaful operators, such as those in the Dubai International Financial Centre (DIFC) and Abu Dhabi Global Market (ADGM), have separate regulatory authorities.

The regulatory framework established by the CBUAE aims to ensure Shari'ah compliance in Takaful operations, requiring providers to align their businesses with Islamic principles. A Shari'ah Supervisory Board (SSB) oversees investments, underwriting procedures, and claims management. The regulations mandate separate investment strategies for participants' and shareholders' funds, reflecting their distinct investment objectives and targets. Additionally, guidelines are provided for the provision of qard to cover deficits within Takaful funds, with a mandate to write off any outstanding qard after three years. Surplus distribution guidelines are also outlined.

Financial regulations offer operators the flexibility to choose between the Wakala Model or the Hybrid Model, with prescribed limits on wakala fees for general Takaful operations and actuarial recommendation in the case of chargeable wakala fees for family Takaful operations.

The Financial Regulations for Takaful Insurance Companies lay down specific requirements with respect to financial reporting for Takaful operators and prescribe that these be in line with the AAOIFI standards.

In various jurisdictions, such as Oman and Kuwait, the formulation of Takaful-specific regulations is either in progress or not explicitly defined. Qatar, presently in the process of shaping regulatory frameworks, is expected to integrate Takaful requirements within its insurance laws for onshore operations. These nations are navigating the evolution of insurance regulations, potentially extending to Takaful, to cater to the growing interest and unique operational aspects of Islamic insurance.

3.1.2 OPERATIONAL FRAMEWORK

The operational framework in Takaful pertains to the strategy adopted by insurance companies engaging in Takaful operations. This primarily encompasses whether companies are established solely for Takaful operations, operate Takaful through subsidiaries, or integrate Takaful within existing structures via a dedicated window.

Internationally, major conventional insurance and reinsurance companies, including Munich Re, Swiss Re, Hannover Re, and AIG, function either through subsidiaries or Takaful windows to engage in Takaful operations. Nigeria allows both standalone Takaful operators and traditional insurers using Takaful windows. Pakistan follows a similar strategy, allowing conventional insurers to offer Takaful products through Takaful windows.

However, Malaysian regulations favor standalone Takaful operators exclusively, disallowing the operation of Takaful windows. These regulations also mandate the segregation of funds for General and Family Takaful businesses by Takaful operators, promoting distinct financial management within the sector. In the UAE, conventional insurers are restricted from partaking in Takaful operations via windows. Takaful companies in the UAE strictly comply with the Executive Regulations and directives from the Central Bank of the UAE, following specific financial regulations designed for Takaful entities in the country.

In Bahrain and Qatar, the regulations don't expressly prohibit window Takaful operations, but specific guidelines addressing this aspect are not explicitly outlined in their rulebooks. In the Kingdom of Saudi Arabia, insurance operates under cooperative principles, which differ conceptually from the Takaful model. There aren't specific regulations governing Takaful operations, and the cooperative insurance model is the prevalent approach.

3.1.3 TAKAFUL FRAMEWORK

The Takaful structure typically includes a Shari'ah Advisory Board comprised of knowledgeable scholars overseeing its compliance with Islamic principles. This board guides the effective administration of Takaful operations and supports risk and commercial strategies. Its primary role is to endorse a Shari'ah-compliant framework for business conduct that ensures long-term success.

This framework entails policies and processes covering Shari'ah contracts, establishment, and management of Takaful funds, product design, underwriting, Retakaful administration, investments, claims, remuneration, operating costs, surplus distribution to participants, and addressing deficits. Specific contractual obligations to participants, participant cooperation, and board approval for surplus or profit distribution are detailed within these policies.

Senior management holds the responsibility of ensuring the framework's effective implementation, necessitating a strong foundation, robust IT systems, adequate human resources, internal communication strategies, and transparency. Regular assessments are imperative to ensure the framework's compliance and to seek ongoing board approval (Bank Negara Malaysia).

3.2 TAKAFUL FUNDS

3.2.1 ESTABLISHMENT OF TAKAFUL FUNDS

Article 90 of the Islamic Financial Services Act (IFSA) 2013, outlined by Bank Negara Malaysia, mandates licensed Takaful operators to create distinct general or family Takaful funds independent of their shareholders' funds. This separation is crucial as Takaful funds are participant-owned and necessitate management to safeguard their interests. The operator is obliged to develop comprehensive policies and procedures for setting up these funds, encompassing the formation of participants' risk funds or participants' investment funds. Each fund holds unique liability profiles and objectives, differentiating them from one another.

The categorization of Takaful funds commonly includes three types:

1. Participants' Takaful Fund
2. Participants' Investment Fund
3. Shareholders' Takaful Fund

3.2.2 PARTICIPANTS' TAKAFUL FUND

The Participants' Takaful Fund, also referred to as Participants' Risk Fund, is a Shari'ah-compliant fund established within the Takaful framework, designed to pool contributions from participants for the purpose of mutual assistance. It serves as a risk-sharing pool where a portion of the contributions is designated as Tabarru to aid other members in the event of covered contingencies or losses. This fund typically consists of contributions from participants and, after deductions such as Wakala fees, it is used to cover various expenses like claims, ReTakaful, administrative costs, and investments in Shari'ah-compliant avenues. Any surplus generated within this fund is returned to the participants. The Participants' Takaful Fund functions to ensure financial protection, security, and support for the participating members while adhering to Islamic principles.

The main features of the participants' fund are as follows:

- It caters to the risk - gross contribution is received into this fund and Wakala charge is levied (wakala is then expensed out and transferred to the shareholders' fund)

- Participants' investments are made from this fund with the objective of healthy risk-free returns also ensuring liquidity.
- In case of a deficit in the Participants' Fund, an interest free loan (Qard-e-Hasn) is provided from the Shareholders' Fund
- There can be multiple participants' funds - one for general Takaful, one for family Takaful, and possibly a third one for health Takaful. However, the overall purpose and function of this fund remains the same.

In the UAE, for example, it is mandatory to have separate participants' funds for the general and family Takaful portfolios. In Pakistan, regulations prevent the coexistence of general and family Takaful operations within the same company, prompting the operation of distinct entities for each.

3.2.3 PARTICIPANTS' INVESTMENT FUND

The Participants' Investment Fund comes into play when a Takaful Operator offers savings products within its Family Takaful Fund. Here, participants' investments, also referred to as unit investments, are specifically segregated and managed within this fund. Investments made from this fund are subject to risk, which is effectively borne by the participants. In contrast, for a general Takaful operator, such a fund does not exist. Instead, the investment income generated from the participants' risk fund is considered part of the same fund, where the net investment return contributes to the participants' surplus after deducting any Mudarib share (relevant in hybrid and wakala models).

3.2.4 SHAREHOLDERS' FUND

The Shareholders' Fund serves as a financial cushion for potential shortfalls in participants' funds. Should any participant fund face a deficit, this fund steps in to offer an interest-free loan (Qard-e-Hasn). Additionally, it's designed to cover infrastructure startup costs and any overruns, such as those exceeding the Wakala levy charged.

The main features of the shareholders' fund are as follows:

- It caters to general and administrative expenses.
- The Wakala fee is the major source of income for this fund.
- Shareholders' investments are made from this fund with an objective of higher returns - riskier investment avenues than the participants' funds.

3.3 INVESTMENT MANAGEMENT UNDER THE TAKAFUL FRAMEWORK

3.3.1 INVESTMENT CONSIDERATIONS FOR TAKAFUL

As per the recommendations of the Shari'ah Advisory Board, Takaful investments should strictly adhere to Shari'ah-compliant channels. This means no direct investments in traditional interest-bearing securities or in private or public shares involving prohibited activities (Ali, 2016).

Moreover, a Takaful operator should tailor distinct investment strategies for the participants' fund and the shareholders' fund due to their different objectives.

In order to ensure compliance with Shari'ah principles and meet participants' expectations, licensed operators must prudently manage Takaful fund investments. This involves implementing a robust system for investment management, precise estimation of returns, and clear policies for cross-fund trading. These policies should outline

trading objectives, compliant asset types, cross-trading procedures, control systems, and escalation protocols for the sustainability of funds and the welfare of participants (Bank Negara Malaysia).

3.3.2 INVESTMENT STRATEGY

Takaful operators' investment strategy is to manage assets in a sound and prudent manner matching the liquidity requirements and focusing on preserving capital with the goal of steady investment income. To achieve this, the operator should try to maximize returns by investing in a balanced and well diversified portfolio based on Islamic Shari'ah principles, while at the same time preserving the value of invested assets.

The investment strategy for Takaful operators aims to prudently manage assets, ensuring liquidity, while preserving capital and securing consistent investment income. Achieving these goals involves maximizing returns through a balanced, diversified portfolio adhering to Islamic Shari'ah principles.

To effectively implement the investment strategy, several key steps are essential:

1. Identifying authorized individuals for asset transactions.
2. Imposing constraints on portfolio managers, such as risk limits outlined in the investment policy.
3. Selecting and utilizing brokers.
4. Clearly defining custodial arrangements.
5. Establishing the methodology and frequency for performance measurement.
6. Agreed-upon transaction reporting formats and frequency.
7. When outsourcing investment management, formalizing policies and procedures in a contract.

3.3.3 MANAGEMENT OF PARTICIPANTS' SURPLUS

Any surplus within the participants' fund is earmarked for future risk provisions in line with the mutuality principle, with guidance provided by the Appointed Actuary and the Shari'ah Board. Should the Takaful surplus exceed the necessary reserve, regulations allow for surplus distribution among participants, subject to regulatory requirements and approvals from the Shari'ah Supervisory Board and the Appointed Actuary.

However, if claims exceed contributions, a deficit within the participants' fund is covered through an equivalent transfer of an interest-free loan (Qard-e-Hasn) from the shareholders' fund. Any outstanding Qard is then recovered from future surpluses.

3.3.4 CONSOLIDATION OF PARTICIPANTS' FUNDS

If an authorized Takaful operator believes consolidating multiple participants' funds will increase the long-term sustainability of Takaful funds, they may do so. The consolidation must involve a sustainability evaluation, participant fairness analysis, actuarial evaluation, and confirmation that there is no outstanding Qard under any of the funds being considered for consolidation (Bank Negara Malaysia).

3.3.5 SHARI'AH-COMPLIANT INVESTMENTS

Shari'ah-compliant investments adhere to Islamic principles, avoiding activities such as gambling, riba, and investing in businesses involved in alcohol, pork, or other forbidden activities. They also comply with ethical and moral standards set by Islamic law. Some Shari'ah-compliant investment avenues include:

SUKUK

Sukuk refers to Islamic financial instruments, commonly known as Islamic bonds, structured to adhere to Islamic principles. These securities are based on asset ownership or participation in specific projects, rather than debt ownership. Sukuk holders receive a portion of the profits generated by the underlying asset or project instead of fixed interest payments, in compliance with Shari'ah law.

SHARI'AH-COMPLIANT EQUITIES

Refers to stocks or shares of companies that operate in accordance with Shari'ah guidelines. These equities are considered Shari'ah-compliant if the businesses they represent adhere to specific guidelines, such as avoiding involvement in activities that go against Islamic teachings, such as interest-based financing, gambling, alcohol, pork-related products, and other unethical or non-permissible activities. Shari'ah-compliant equities are vetted by Shari'ah boards or scholars to ensure adherence to Islamic finance principles.

SHARI'AH-COMPLIANT MUTUAL FUNDS

These are investment vehicles that adhere to Shari'ah principles in their investment activities. These funds follow guidelines outlined by Islamic law, avoiding investments in non-permissible industries such as alcohol, gambling, and other prohibited activities. Instead, they invest in Shari'ah-compliant assets, like Shari'ah-compliant equities, Sukuk, real estate, and other permissible ventures.

IJARAH FUNDS

Ijarah funds are a type of investment vehicle in Islamic finance that follows the principles of Ijarah, a leasing or rental contract. These funds pool investments from participants to acquire assets such as real estate, equipment, or vehicles. The funds then lease these assets to third parties, generating rental income. The returns from these leases are distributed among the fund participants in a Shari'ah-compliant manner. The funds are managed in accordance with Islamic finance principles, ensuring that the investments and leasing contracts comply with Shari'ah guidelines.

MURABAHA FUNDS

Murabaha funds are a type of financial instrument in Islamic finance that operate based on the Murabaha contract. This contract involves the sale of goods at a marked-up price, allowing for deferred payment terms. In the context of these funds, investors pool their capital, which is then utilized by the fund managers to purchase goods or commodities. These goods are subsequently sold to buyers at a higher price, with payment typically deferred. The profit generated from these transactions forms the returns for investors in the Murabaha fund. This financial structure complies with Shari'ah principles that prohibit the charging or payment of interest (riba) and adheres to Islamic guidelines on ethical and fair-trade practices.

3.3.6 ROLES AND RESPONSIBILITIES OF THE INVESTMENT COMMITTEE

The Investment Committee within a Takaful enterprise holds a pivotal role in overseeing and managing the investment activities of the participants' and shareholders' funds. Their responsibilities typically include:

- Developing and formulating the overall investment strategy aligned with Shari'ah principles, risk tolerance, and the company's objectives. This includes setting investment goals, asset allocation strategies, and risk management practices.
- Establishing investment policies, guidelines, and procedures that comply with Shari'ah principles and regulatory requirements. This involves defining the permissible investment avenues and the framework for evaluating and approving investments.
- Determining the allocation of assets across various investment classes, such as equities, real estate, Sukuk, Islamic funds, and other permissible investment vehicles, in accordance with the company's risk profile and objectives.
- Conducting due diligence on potential investment opportunities to ensure they comply with Shari'ah guidelines, evaluating their financial soundness, risk levels, and alignment with the company's ethical standards.
- Assessing and managing investment-related risks, establishing risk tolerance levels, and implementing strategies to mitigate risks while optimizing returns.
- Regularly monitoring the performance of investments against set benchmarks, assessing compliance with investment policies, and preparing comprehensive reports for the board of directors and regulatory bodies.
- Advising the board of directors on investment-related matters, providing insights, recommendations, and guidance on investment strategies, opportunities, and market conditions.
- Collaborating with the Shari'ah Advisory Board to ensure that all investment decisions and practices adhere to Shari'ah principles and guidelines.

The contrast between conventional insurance and Takaful business becomes particularly evident when examining their investment practices. Traditional insurance companies typically invest their funds in interest-based avenues, often disregarding considerations of what is permissible or prohibited in Islamic finance. In contrast, Takaful operators strictly engage in Shari'ah-compliant investments, and any profits generated are distributed according to the predetermined ratios outlined in the Takaful contract.

Moreover, Takaful companies operate on a collective principle, where participants collectively share both surpluses and losses from the shared pool. This intrinsic feature of the Takaful system acts as a built-in mechanism to counteract any over-pricing tendencies exhibited by conventional insurance companies. Regardless of the contributions charged, any surplus typically flows back to the participants in proportion to their individual contributions. This aligns with the principle of fairness and equity in Takaful operations (Usmani, 2002).

3.4 RESPONSIBILITIES OF THE SHAREHOLDERS

Shareholders in a Takaful enterprise, as owners, hold significant responsibilities crucial for the company's function and adherence to Shari'ah principles. Their duties encompass multiple facets:

- Carefully selecting and appointing a competent Takaful operator to manage Takaful funds and operations. The operator must possess expertise in Shari'ah-compliant fund management, upholding the trust and integrity of the Takaful enterprise.
- Financing any deficits arising within the Takaful funds through interest-free loans, recovered from future surpluses, ensuring the stability of the participants' funds.
- Entitled to a share of the profits generated by the company, while bearing responsibility for any incurred losses. They support the administrator, overseeing fund activities like risk underwriting and investments.

- Guaranteeing compliance with Shari'ah principles in all company operations, ensuring transparency and fair dealings for stakeholders.
- Protecting the interests and rights of the participants by ensuring that the Takaful company has sufficient funds to meet its liabilities and obligations.
- Maintaining a prudent level of solvency, liquidity, and effective risk management systems.
- Prioritizing transparency, disclosing financial performance and participant rights, informing them about investment strategies, surplus distribution criteria, and claims settlement processes.

Section 4: Takaful Models

The Takaful industry has evolved to offer various models catering to consumer demands, while adhering to Shari'ah standards. This section aims to introduce and detail these models, providing insights into their structures and unique features.

4.1 HYBRID (WAKALA & MUDARABAH) MODEL

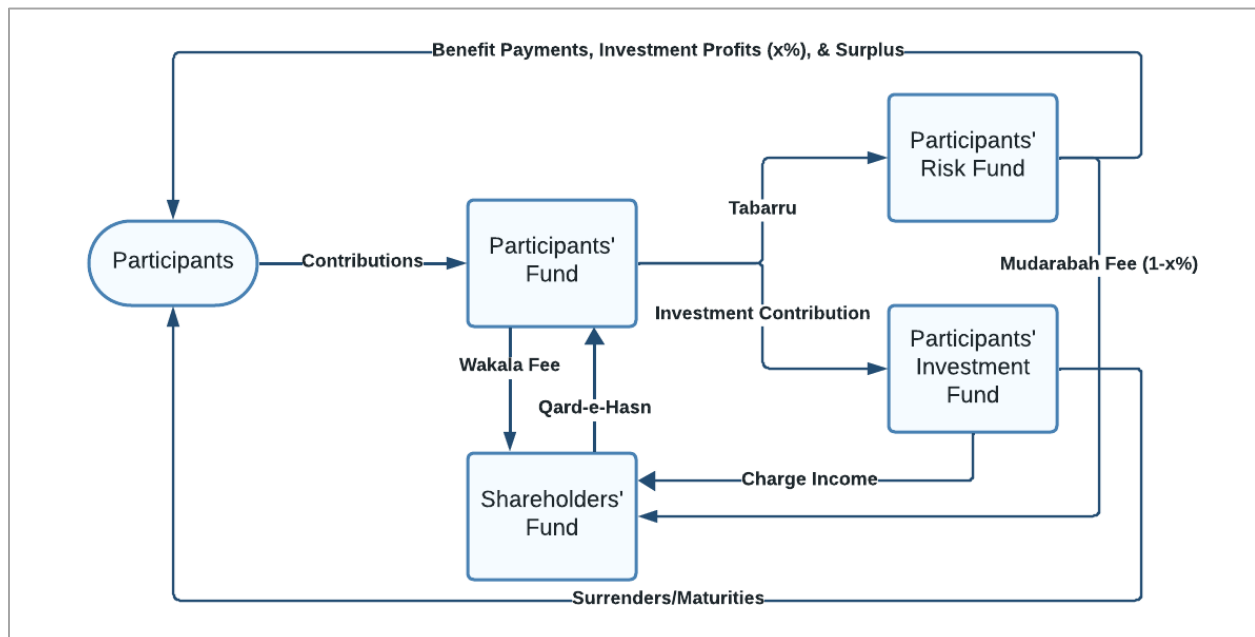
The hybrid model combines elements of both the Wakala and the Mudarabah¹ models. A Mudarabah contract is used for investing activities, whereas a Wakala contract is used for underwriting activities.

Through a Wakala contract, shareholders manage participants' contributions in underwriting activities as their agents. Participants pay a Wakala fee to the Takaful operator in exchange for these services. The business uses the Mudarabah contract for investments, placing surplus contributions in Shari'ah-compliant securities.

In accordance with a predetermined and approved profit-sharing ratio, the operator serves as mudarib on behalf of the participants for the sake of participants' investments. In addition to serving as an investment manager under the Mudarabah contract and splitting profits from such investments, the Takaful operator charges a Wakala fee to manage participants' risk funds. Some Takaful operators may retain a fraction of the participants' surplus as an incentive.

Investment income is distributed in accordance with predetermined ratios where the funds are invested in Shari'ah-compliant schemes. Participants' funds pay for claims, underwriting fees, and Retakaful charges. In the event of losses, deficits are covered through a provision of Qard-e-Hasn from the shareholders' fund, with future surplus from the participants' fund serving as payback (Akhter & Waheed, 2010).

Figure 4
HYBRID MODEL



¹ Commonly referred to as the Cooperative Model

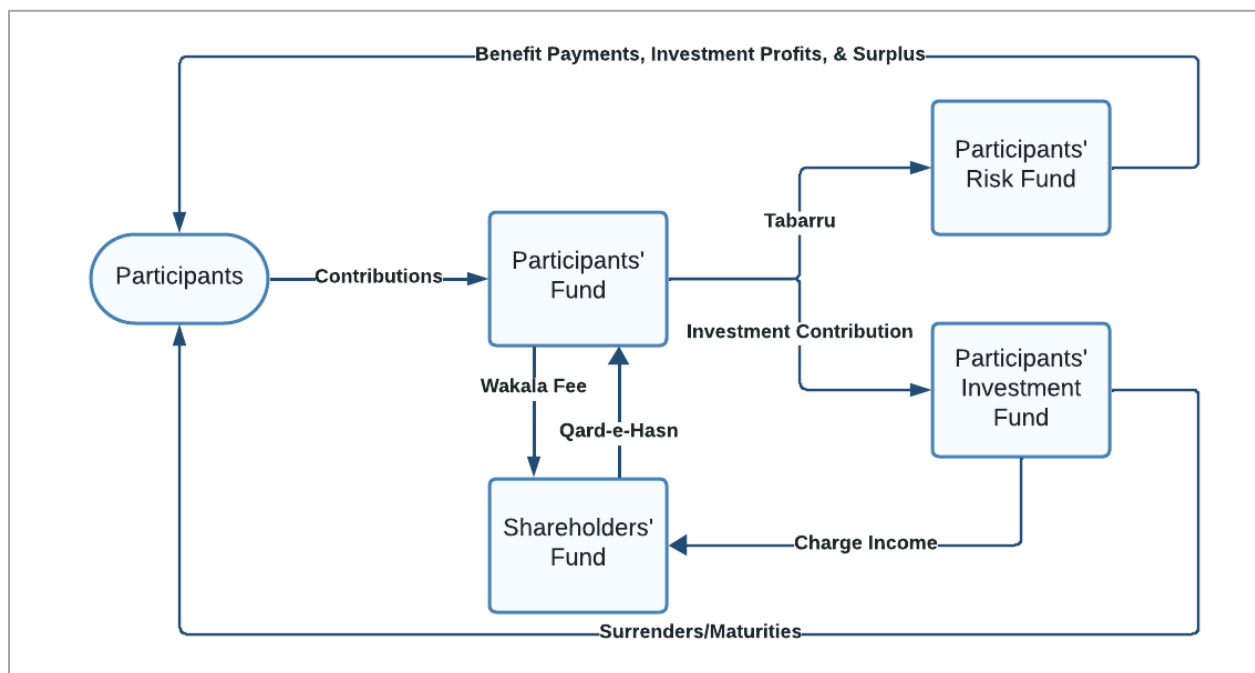
4.2 WAKALA MODEL

In this model, the Takaful operator functions as an agent, charging a predetermined Wakala fee for its services. This fee is fixed, ensuring a stable income for the operator irrespective of the performance of the participants' funds. The Wakala fee compensates the operator for managing the participants' funds, carrying out administrative duties, and overseeing day-to-day operations. In addition to the levied Wakala, certain jurisdictions permit the inclusion of an incentive charge equal to a portion of the surplus within the participants' fund. This additional charge is justified by the idea that it will encourage thorough underwriting, lower claim costs, etc.

In case the participants' fund faces a deficit due to benefit payments being higher than expected, the Wakala model allows the Takaful operator to cover this deficit by extending an interest-free loan known as Qard-e-Hasn from the shareholders' fund. This loan is provided to ensure that the participants' fund remains solvent and can fulfill its obligations. The Qard-e-Hasn is later repaid from future surpluses generated by the participants' fund.

Compared to the Hybrid model, which combines elements of Mudarabah and Wakala, the Wakala model doesn't involve profit-sharing from the investment activities conducted within the participants' funds. Instead, the Takaful operator receives a fixed Wakala fee for managing the funds without sharing in the investment profits.

Figure 5
WAKALA MODEL



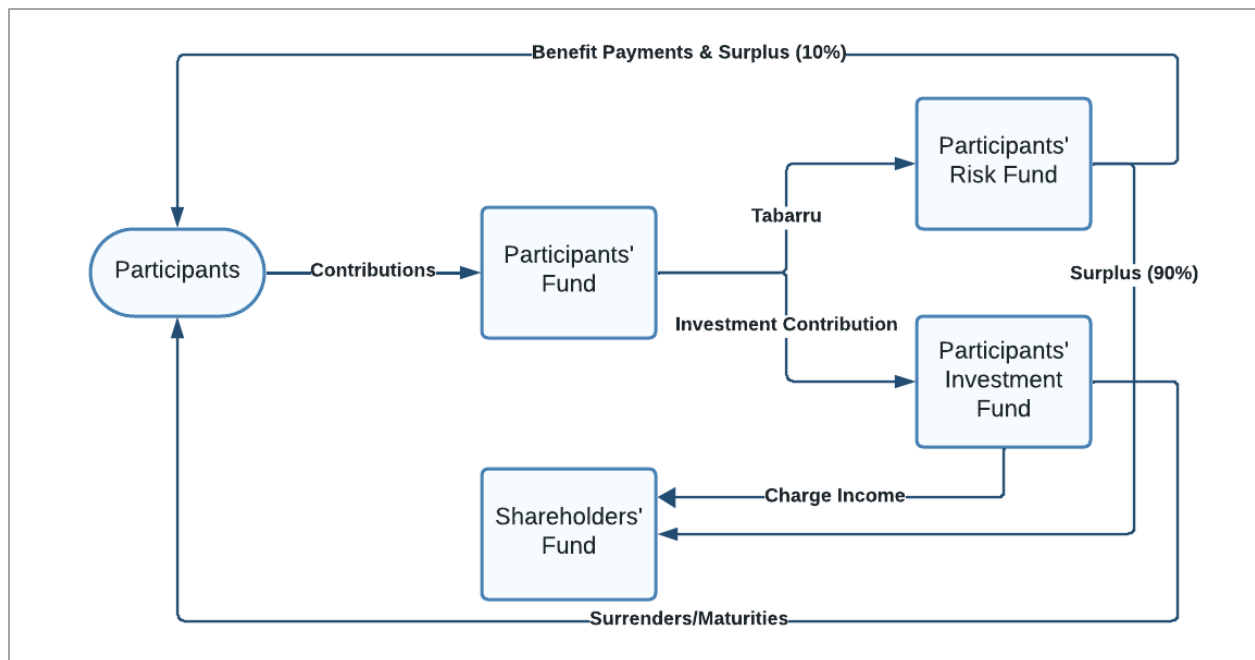
4.3 COOPERATIVE MODEL

Mudarib, the Takaful operator, and the participants have a profit-sharing agreement. Mudarib manages investments and claims payments, while the participants contribute to a collective fund. The underwriting surplus and investment income are split between the participants and the shareholders using a predefined ratio. The capital provider absorbs losses (Usmani, 2020).

One distinctive feature of the cooperative model is the existence of a single fund, much like conventional insurers or mutuals. However, unlike conventional setups, any surplus or profits generated are divided between the participants and the shareholders based on a predefined ratio. For instance, in the Kingdom of Saudi Arabia (KSA), the profit-sharing mechanism is prescribed by the regulatory authority, where 90% of the generated surplus is attributable to the shareholders and the remainder to the participants.

In the scenario of a surplus, the agreed percentage of profits goes to the participants, fostering a cooperative approach by sharing the benefits among them and the shareholders. However, in the event of a deficit, the shareholders bear the entire burden, covering 100% of the deficit, thus showcasing the risk-bearing responsibility of the capital providers. This arrangement aligns with the principles of risk-sharing and mutual support within the cooperative model.

Figure 6
COOPERATIVE MODEL



4.4 TAKAFUL-SPECIFIC TRANSACTIONS

The description provided below of the Takaful-specific transactions is applicable only in the case of the Hybrid and Wakala Models.

QARD-E-HASN

Qard-e-Hasn is an interest-free loan provided by the shareholders of a Takaful company to cover any deficits within the participants' fund. In the context of Takaful, if there's a shortfall or deficit in the participants' fund due to excessive claims or unexpected circumstances, this loan is extended from the shareholders' fund to cover the shortage. It is provided on a goodwill basis and aims to restore the financial health of the participants' fund. Qard-e-Hasn is interest-free and is expected to be repaid from future surpluses within the participants' fund once it regains financial stability. This mechanism ensures that any temporary financial shortfall within the Takaful fund doesn't affect the participants' benefits and obligations adversely.

WAKALA FEE

The Wakala fee within the Takaful framework refers to a charge levied by the Takaful operator for its services in managing and administering the Takaful funds. It is compensation for the operator's role in conducting underwriting activities on behalf of the participants, as well as covering the costs of managing the fund, handling claims, and other administrative expenses incurred by the operator. This fee is usually predefined and, in some jurisdictions, a maximum limit is prescribed, such as in the UAE, where the financial regulations for Takaful operators prescribe a maximum limit of 35%. The fee may vary depending on the Takaful contract, the type of coverage, and the services provided by the operator.

MUDARABAH FEE

The Mudarabah fee within the Takaful framework is a portion of the surplus generated from Shari'ah-compliant investments by the Takaful operator on behalf of the participants. It represents the operator's share of profits earned through successful investment activities conducted under the Mudarabah contract.

The Takaful operator acts as the Mudarib, responsible for managing and investing the participants' funds in permissible and profitable ventures. Any surplus generated from these investments, after deducting operational expenses and other charges, is distributed among the participants and the operator, based on a pre-agreed profit-sharing ratio. The fee is the share of profits that the Takaful operator receives as compensation for its expertise, efforts, and role in generating investment income. The Mudarabah fee aligns the interests of the operator with the financial performance of the investments made on behalf of the participants.

4.5 TAKAFUL MODELS IMPLEMENTED GLOBALLY

Numerous nations have adopted diverse Takaful models since its inception. Pakistan, Malaysia, and the Gulf countries stand out as prominent markets. Notably, the insurance markets in the GCC region, particularly in the Kingdom of Saudi Arabia and the United Arab Emirates (UAE), are well-developed. Takaful providers in the UAE and Bahrain operate using the Hybrid model (Wakala & Mudarabah), while the regulatory authority in the Kingdom of Saudi Arabia has prescribed using the Cooperative model (Mudarabah). Pakistan, on the other hand, favors the Hybrid or Wakala model.

The Hybrid model is prevalent in the United Arab Emirates, Pakistan, Bahrain, and Malaysia. These countries offer the option of adopting a pure Wakala model or a combination of approaches. Particularly in Malaysia, the Hybrid model finds extensive use and proponents argue that it harmonizes the strengths of both models, promoting standardization of Takaful practices (Obaidullah, 2005).

4.6 ILLUSTRATIVE PROFIT & LOSS STATEMENTS UNDER VARIOUS TAKAFUL MODELS

This subsection provides for the illustrative profit and loss statements under each Takaful model discussed above considering various scenarios, including a brief discussion around the key differences in the financial reporting framework under each model. For the sake of readers' ease, the following simplified assumptions have been made:

- An Illustrative Profit and Loss Statement under each Takaful Model has been provided using three distinct scenarios.
- Earned Contribution has been assumed to be CU 1,000 per annum.
- Expense Ratio has been assumed to be 20%.
- Wakala Fee² has been assumed to be 25% of Gross Contributions.
- Mudarabah Fee³ has been assumed to be 20% of Investment Income.
- Participants' Investment Income has been assumed to be CU 50 per annum.
- Shareholders' Investment Income has been assumed to be CU 100 per annum.
- Surplus-sharing under the Cooperative Model has been assumed to be in line with that prescribed by the Insurance Authority in the KSA, where 10% of the surplus is allocated to the participants and the remaining 90% is attributable to the shareholders.
- Three scenarios have been considered under each Takaful Model. The first scenario provides for an entity generating profits over the next five years, whereas the second scenario provides for an entity generating losses over the same period. However, under the third scenario, the entity generates losses during the first two years and profits thereafter.

Table 4
ASSUMED LOSS RATIOS

ASSUMED LOSS RATIOS					
	Year 1	Year 2	Year 3	Year 4	Year 5
Scenario 1	65%	65%	65%	65%	65%
Scenario 2	100%	100%	100%	100%	100%
Scenario 3	100%	100%	50%	50%	50%

² Applicable in the case of Hybrid and Wakala Models

³ Applicable only in the case of the Hybrid Model

HYBRID (WAKALA & MUDARABAH) MODEL – SCENARIO 1

Table 5

PROFIT AND LOSS STATEMENT FOR THE PARTICIPANTS' FUND AND THE SHAREHOLDERS' FUND

PARTICIPANTS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Contributions	750.00	750.00	750.00	750.00	750.00
Incurred Claims	(650.00)	(650.00)	(650.00)	(650.00)	(650.00)
Underwriting Profit/(Loss)	100.00	100.00	100.00	100.00	100.00
Investment Income (Participants' Investment)	50.00	50.00	50.00	50.00	50.00
Mudarabah Fee	(10.00)	(10.00)	(10.00)	(10.00)	(10.00)
Profit/(Loss)	140.00	140.00	140.00	140.00	140.00

SHAREHOLDERS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Wakala	250.00	250.00	250.00	250.00	250.00
Incurred Expenses	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Underwriting Profit/(Loss)	50.00	50.00	50.00	50.00	50.00
Investment Income (Shareholders' Investment)	100.00	100.00	100.00	100.00	100.00
Mudarabah Income	10.00	10.00	10.00	10.00	10.00
Profit/(Loss)	160.00	160.00	160.00	160.00	160.00

In practice, gross contribution is treated as an inflow into the participants' fund, whereas the levied wakala is treated as an outflow from the same fund which, in turn, is treated as an inflow into the shareholders' fund.

In addition, a mudarabah fee is levied on the participants' investment income, which is considered an expense to the participants and an income to the shareholders.

Table 6

ENTITY LEVEL PROFIT AND LOSS STATEMENT

ENTITY					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Revenue	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Incurred Claims & Expenses	(850.00)	(850.00)	(850.00)	(850.00)	(850.00)
Underwriting Profit/(Loss)	150.00	150.00	150.00	150.00	150.00
Investment Income	150.00	150.00	150.00	150.00	150.00
Profit/(Loss)	300.00	300.00	300.00	300.00	300.00

Combining the participants' fund and the shareholders' fund in a Takaful entity eliminates specific accounting items, such as the wakala and mudarabah fees, from a presentation standpoint. These are treated as inter-fund transactions within the same entity. In essence, the total profits or losses from both funds contribute to the overall aggregate profits or losses for the entity.

HYBRID (WAKALA & MUDARABAH) MODEL – SCENARIO 2

Table 7

PROFIT AND LOSS STATEMENT FOR THE PARTICIPANTS' FUND AND THE SHAREHOLDERS' FUND

PARTICIPANTS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Contributions	750.00	750.00	750.00	750.00	750.00
Incurred Claims	(1,000.00)	(1,000.00)	(1,000.00)	(1,000.00)	(1,000.00)
Underwriting Profit/(Loss)	(250.00)	(250.00)	(250.00)	(250.00)	(250.00)
Investment Income (Participants' Investment)	50.00	50.00	50.00	50.00	50.00
Mudarabah Fee	(10.00)	(10.00)	(10.00)	(10.00)	(10.00)
Profit/(Loss)	(210.00)	(210.00)	(210.00)	(210.00)	(210.00)
Interest Fee Loan (Qard) from Shareholders	210.00	210.00	210.00	210.00	210.00

SHAREHOLDERS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Wakala	250.00	250.00	250.00	250.00	250.00
Incurred Expenses	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Underwriting Profit/(Loss)	50.00	50.00	50.00	50.00	50.00
Investment Income (Shareholders' Investment)	100.00	100.00	100.00	100.00	100.00
Mudarabah Income	10.00	10.00	10.00	10.00	10.00
Profit/(Loss)	160.00	160.00	160.00	160.00	160.00
Interest Free Loan (Qard) to Policyholders'	(210.00)	(210.00)	(210.00)	(210.00)	(210.00)

Under this scenario, where the participants' fund is consistently making losses, an interest-free loan (Qard-e-Hasn) is provided from the shareholders' fund to cover the deficits within the participants' fund. From a balance sheet perspective, any Outstanding Qard would be shown as a payable (liability) under the participants' fund, whereas it would be shown as a receivable (asset) under the shareholders' fund. As previously mentioned, an entity level view of the balance sheet will eliminate Qard as an inter-fund transaction.

Table 8
ENTITY LEVEL PROFIT AND LOSS STATEMENT

ENTITY					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Revenue	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Incurred Claims & Expenses	(1,200.00)	(1,200.00)	(1,200.00)	(1,200.00)	(1,200.00)
Underwriting Profit/(Loss)	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Investment Income	150.00	150.00	150.00	150.00	150.00
Profit/(Loss)	(50.00)	(50.00)	(50.00)	(50.00)	(50.00)

HYBRID (WAKALA & MUDARABAH) MODEL – SCENARIO 3

Table 9
PROFIT AND LOSS STATEMENT FOR THE PARTICIPANTS' FUND AND THE SHAREHOLDERS' FUND

PARTICIPANTS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Contributions	750.00	750.00	750.00	750.00	750.00
Incurred Claims	(1,000.00)	(1,000.00)	(500.00)	(500.00)	(500.00)
Underwriting Profit/(Loss)	(250.00)	(250.00)	250.00	250.00	250.00
Investment Income (Participants' Investment)	50.00	50.00	50.00	50.00	50.00
Mudarah Fee	(10.00)	(10.00)	(10.00)	(10.00)	(10.00)
Profit/(Loss)	(210.00)	(210.00)	290.00	290.00	290.00
Interest Fee Loan (Qard) from Shareholders	210.00	210.00	(290.00)	(130.00)	-

SHAREHOLDERS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Wakala	250.00	250.00	250.00	250.00	250.00
Incurred Expenses	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Underwriting Profit/(Loss)	50.00	50.00	50.00	50.00	50.00
Investment Income (Shareholders' Investment)	100.00	100.00	100.00	100.00	100.00
Mudarah Income	10.00	10.00	10.00	10.00	10.00
Profit/(Loss)	160.00	160.00	160.00	160.00	160.00
Interest Free Loan (Qard) to Policyholders	(210.00)	(210.00)	290.00	130.00	-

Under this scenario, where the participants' fund has incurred losses during the first two years, note that an equivalent Qard has been transferred from the shareholders' fund; however, when the participants' fund becomes profitable from year 3 onwards, any outstanding Qard is paid back first before distribution of surplus to the participants. At the end of year 2, accumulated Qard stands at CU 420.00, out of which CU 290.00 is paid back at the end of year 3, whereas the remainder of CU 130.00 is paid back at the end of year 4, leaving a surplus CU 160.00 within the participants' fund. This surplus can either be distributed to the active participants or carried forward as accumulated surplus.

Table 10

ENTITY LEVEL PROFIT AND LOSS STATEMENT

ENTITY					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Revenue	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Incurred Claims & Expenses	(1,200.00)	(1,200.00)	(700.00)	(700.00)	(700.00)
Underwriting Profit/(Loss)	(200.00)	(200.00)	300.00	300.00	300.00
Investment Income	150.00	150.00	150.00	150.00	150.00
Profit/(Loss)	(50.00)	(50.00)	450.00	450.00	450.00

WAKALA MODEL – SCENARIO 1

As explained in Section 2 of this paper, the wakala model differs from the hybrid model only in the case of the mudarabah fee levied on the participants' investment income. Under the wakala model, 100% of the participants' investment income is considered income for said fund.

Table 11

PROFIT AND LOSS STATEMENT FOR THE PARTICIPANTS' FUND AND THE SHAREHOLDERS' FUND

PARTICIPANTS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Contributions	750.00	750.00	750.00	750.00	750.00
Incurred Claims	(650.00)	(650.00)	(650.00)	(650.00)	(650.00)
Underwriting Profit/(Loss)	100.00	100.00	100.00	100.00	100.00
Investment Income (Participants' Investment)	50.00	50.00	50.00	50.00	50.00
Profit/(Loss)	150.00	150.00	150.00	150.00	150.00

SHAREHOLDERS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Wakala	250.00	250.00	250.00	250.00	250.00
Incurred Expenses	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Underwriting Profit/(Loss)	50.00	50.00	50.00	50.00	50.00
Investment Income (Shareholders' Investment)	100.00	100.00	100.00	100.00	100.00
Profit/(Loss)	150.00	150.00	150.00	150.00	150.00

Comparing Scenario 1 under the Hybrid Model with that shown above, note that the difference in profitability of the participants' fund only relates to the levied Mudarabah fee under the Hybrid Model, which is non-existent under the Wakala Model. Similarly, profits within the shareholders' fund would also be lower compared to those under the Hybrid Model where the mudarabah fee is additional income to the shareholders. Shown below is the entity level profit and loss statement, which is the same as the Hybrid Model due to the amalgamation of funds and elimination of Takaful-specific inter-fund transactions:

Table 12
ENTITY LEVEL PROFIT AND LOSS STATEMENT

ENTITY					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Revenue	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Incurred Claims & Expenses	(850.00)	(850.00)	(850.00)	(850.00)	(850.00)
Underwriting Profit/(Loss)	150.00	150.00	150.00	150.00	150.00
Investment Income	150.00	150.00	150.00	150.00	150.00
Profit/(Loss)	300.00	300.00	300.00	300.00	300.00

WAKALA MODEL – SCENARIO 2

Under Scenario 2, the participants' fund generates a deficit across all years. When compared with the same scenario under the Hybrid Model, the only difference in the bottom line of each fund relates to the absence of the mudarabah fee/income under the Wakala Model. Presented below is the profit and loss statement for the two funds under Scenario 2:

Table 13
PROFIT AND LOSS STATEMENT FOR THE PARTICIPANTS' FUND AND THE SHAREHOLDERS' FUND

PARTICIPANTS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Contributions	750.00	750.00	750.00	750.00	750.00
Incurred Claims	(1,000.00)	(1,000.00)	(1,000.00)	(1,000.00)	(1,000.00)
Underwriting Profit/(Loss)	(250.00)	(250.00)	(250.00)	(250.00)	(250.00)
Investment Income (Participants' Investment)	50.00	50.00	50.00	50.00	50.00
Profit/(Loss)	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Interest Fee Loan (Qard) from Shareholders	200.00	200.00	200.00	200.00	200.00

SHAREHOLDERS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Wakala	250.00	250.00	250.00	250.00	250.00
Incurred Expenses	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Underwriting Profit/(Loss)	50.00	50.00	50.00	50.00	50.00
Investment Income (Shareholders' Investment)	100.00	100.00	100.00	100.00	100.00
Profit/(Loss)	150.00	150.00	150.00	150.00	150.00
Interest Free Loan (Qard) to Policyholders	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)

ENTITY					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Revenue	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Incurred Claims & Expenses	(1,200.00)	(1,200.00)	(1,200.00)	(1,200.00)	(1,200.00)
Underwriting Profit/(Loss)	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Investment Income	150.00	150.00	150.00	150.00	150.00
Profit/(Loss)	(50.00)	(50.00)	(50.00)	(50.00)	(50.00)

WAKALA MODEL – SCENARIO 3

Under Scenario 3, the participants' fund generates deficits during the first two years with profits thereafter. Qard from the shareholders' fund is provided to cover the deficits during the first two years and fully recovered by the end of the fourth year.

Table 14

PROFIT AND LOSS STATEMENT FOR THE PARTICIPANTS' FUND AND THE SHAREHOLDERS' FUND

PARTICIPANTS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Contributions	750.00	750.00	750.00	750.00	750.00
Incurred Claims	(1,000.00)	(1,000.00)	(500.00)	(500.00)	(500.00)
Underwriting Profit/(Loss)	(250.00)	(250.00)	250.00	250.00	250.00
Investment Income (Participants' Investment)	50.00	50.00	50.00	50.00	50.00
Profit/(Loss)	(200.00)	(200.00)	300.00	300.00	300.00
Interest Fee Loan (Qard) from Shareholders	200.00	200.00	(300.00)	(100.00)	-

SHAREHOLDERS' FUND					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Wakala	250.00	250.00	250.00	250.00	250.00
Incurred Expenses	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Underwriting Profit/(Loss)	50.00	50.00	50.00	50.00	50.00
Investment Income (Shareholders' Investment)	100.00	100.00	100.00	100.00	100.00
Profit/(Loss)	150.00	150.00	150.00	150.00	150.00
Interest Free Loan (Qard) to Policyholders	(200.00)	(200.00)	300.00	100.00	-

At the end of year 2, accumulated Qard stands at CU 400.00, out of which CU 300.00 is paid back at the end of year 3, whereas the remainder of CU 100.00 is paid back at the end of year 4, leaving a surplus CU 200.00 within the participants' fund. The accumulated surplus grows to CU 500.00 at the end of the fifth year given an additional CU

300.00 of surplus generated during the same year.

Table 15

ENTITY LEVEL PROFIT AND LOSS STATEMENT

ENTITY					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Revenue	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Incurred Claims & Expenses	(1,200.00)	(1,200.00)	(700.00)	(700.00)	(700.00)
Underwriting Profit/(Loss)	(200.00)	(200.00)	300.00	300.00	300.00
Investment Income	150.00	150.00	150.00	150.00	150.00
Profit/(Loss)	(50.00)	(50.00)	450.00	450.00	450.00

COOPERATIVE MODEL – SCENARIO 1

As discussed in Section 2 of this paper, the cooperative model significantly differs from the Hybrid and Wakala models. The financial reporting under this model is more closely aligned with that under mutual insurance or conventional insurance given there's only one fund and Takaful-specific transactions, such as a wakala fee, mudarabah fee, or Qard, are non-existent. The only key difference relates to the profit-sharing between the participants and the shareholders, which does not exist in the case of conventional insurance.

Table 16

ENTITY LEVEL PROFIT AND LOSS STATEMENT

ENTITY					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Contributions	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Incurred Claims & Expenses	(850.00)	(850.00)	(850.00)	(850.00)	(850.00)
Underwriting Profit/(Loss)	150.00	150.00	150.00	150.00	150.00
Investment Income	150.00	150.00	150.00	150.00	150.00
Profit/(Loss) – Aggregate	300.00	300.00	300.00	300.00	300.00
Profit - Policyholders	30.00	30.00	30.00	30.00	30.00
Profit/(Loss) - Shareholders	270.00	270.00	270.00	270.00	270.00

Note that the aggregate profits are the same as under Scenario 1 of the Hybrid and Wakala Models. As explained in Section 2, aggregate profits of the entity are shared between the participants and shareholders using a pre-defined ratio usually prescribed by the regulatory authority. The ratios used for the purpose of these scenarios are in line with those prescribed by the Insurance Authority in the Kingdom of Saudi Arabia.

From a balance sheet perspective, 'accumulated participants' surplus' is held as a liability with equivalent cash or term deposits on the asset side. In this scenario, accumulated participants' surplus would be CU 150.00 at the end of the fifth year.

COOPERATIVE MODEL – SCENARIO 2

Under this scenario, the entity generates deficits throughout the five years.

Table 17

ENTITY LEVEL PROFIT AND LOSS STATEMENT

ENTITY					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Contributions	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Incurred Claims & Expenses	(1,200.00)	(1,200.00)	(1,200.00)	(1,200.00)	(1,200.00)
Underwriting Profit/(Loss)	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Investment Income	150.00	150.00	150.00	150.00	150.00
Profit/(Loss) – Aggregate	(50.00)	(50.00)	(50.00)	(50.00)	(50.00)
Profit - Policyholders	-	-	-	-	-
Profit/(Loss) - Shareholders	(50.00)	(50.00)	(50.00)	(50.00)	(50.00)

Note that, in this scenario where the entity is generating deficits, 100% of such deficits are attributed to the shareholders. Also, the entity-level aggregate deficits are the same as under Scenario 2 of the Hybrid and Wakala Models.

COOPERATIVE MODEL – SCENARIO 3

Under this scenario, the entity generates deficits during the first two years with surpluses thereafter.

Table 18

ENTITY LEVEL PROFIT AND LOSS STATEMENT

ENTITY					
	Year 1	Year 2	Year 3	Year 4	Year 5
Earned Contributions	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00
Incurred Claims & Expenses	(1,200.00)	(1,200.00)	(700.00)	(700.00)	(700.00)
Underwriting Profit/(Loss)	(200.00)	(200.00)	300.00	300.00	300.00
Investment Income	150.00	150.00	150.00	150.00	150.00
Profit/(Loss) – Aggregate	(50.00)	(50.00)	450.00	450.00	450.00
Profit - Policyholders	-	-	45.00	45.00	45.00
Profit/(Loss) - Shareholders	(50.00)	(50.00)	405.00	405.00	405.00

Note that, at the end of year 3, which is also the first profitable year under this scenario, the surplus is shared using a pre-defined ratio with the participants. Accumulated participants' surplus at the end of the fifth year amounts to CU 135.00, assuming no surplus has been distributed in the past two years.

4.7 COMPARISON – ILLUSTRATIVE EXAMPLES

PARTICIPANTS' FUND

The comparison shown below under each scenario relates only to the Hybrid and the Wakala models. Segregation of the participants' fund and the shareholders' fund is non-existent under the Cooperative Model. The difference in profits or losses is only driven by the absence of the Mudarabah fee under the Wakala Model.

Note that, under the Hybrid Model, in all scenarios, profits/losses are lower/higher by CU 10.00.

Table 19
PARTICIPANTS' FUND

SCENARIO	MODEL	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
Scenario 1	Hybrid Model	140.00	140.00	140.00	140.00	140.00
	Wakala Model	150.00	150.00	150.00	150.00	150.00
Scenario 2	Hybrid Model	(210.00)	(210.00)	(210.00)	(210.00)	(210.00)
	Wakala Model	(200.00)	(200.00)	(200.00)	(200.00)	(200.00)
Scenario 3	Hybrid Model	(210.00)	(210.00)	290.00	290.00	290.00
	Wakala Model	(200.00)	(200.00)	300.00	300.00	300.00

SHAREHOLDERS' FUND

Similarly, the difference in profits or losses within the shareholders' fund is only due to the Mudarabah fee, which is an additional income to the shareholders under the Hybrid Model. Note that under the Hybrid Model, in all scenarios, profits/losses are higher/lower by CU 10.00.

Table 20
SHAREHOLDERS' FUND

SCENARIO	MODEL	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
Scenario 1	Hybrid Model	160.00	160.00	160.00	160.00	160.00
	Wakala Model	150.00	150.00	150.00	150.00	150.00
Scenario 2	Hybrid Model	160.00	160.00	160.00	160.00	160.00
	Wakala Model	150.00	150.00	150.00	150.00	150.00
Scenario 3	Hybrid Model	(210.00)	(210.00)	290.00	290.00	290.00
	Wakala Model	(200.00)	(200.00)	300.00	300.00	300.00

ENTITY

As explained previously, the amalgamation of the two funds would result in the elimination of Takaful-specific transactions and, therefore, entity-level profits or losses would be the same under each of the three Takaful models. Aggregated statements under any Takaful model are also directly comparable with the statements for a conventional insurer or a mutual.

Table 21

ENTITY

SCENARIO	MODEL	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
Scenario 1	Hybrid Model	300.00	300.00	300.00	300.00	300.00
	Wakala Model	300.00	300.00	300.00	300.00	300.00
	Cooperative Model	300.00	300.00	300.00	300.00	300.00
Scenario 2	Hybrid Model	(50.00)	(50.00)	(50.00)	(50.00)	(50.00)
	Wakala Model	(50.00)	(50.00)	(50.00)	(50.00)	(50.00)
	Cooperative Model	(50.00)	(50.00)	(50.00)	(50.00)	(50.00)
Scenario 3	Hybrid Model	(50.00)	(50.00)	450.00	450.00	450.00
	Wakala Model	(50.00)	(50.00)	450.00	450.00	450.00
	Cooperative Model	(50.00)	(50.00)	450.00	450.00	450.00

The illustrative profit and loss statements provided above under various scenarios cover the three most common models practiced across the Takaful industry; however, in practice, financial reporting framework as prescribed by the regulatory authorities could deviate, but would still fit under one of the models discussed above.

Another variation in practice is the non-charging of a wakala fee if there's Qard outstanding. This is usually considered a healthier practice, however uncommon, but provides for the participants' funds to quickly recover from deficits.

In most of the markets where Takaful entities operate and are effectively regulated, the financial reporting framework is usually prescribed by the regulatory authorities. As a best practice, participants' funds should ideally be reported under IFRS 4 (now IFRS 17) or U.S. GAAP, whereas the shareholders' fund should be reported under IFRS 15.

4.8 ACTUARIAL CONSIDERATIONS

The role of actuaries has always been a prominent one in the insurance world with their expertise being utilized by various functions, including product pricing, reserving, capital adequacy assessments, reinsurance optimization, etc. However, this role is more pronounced under the Takaful framework where certain jurisdictions lay out additional requirements for the Appointed Actuaries of the Takaful operators.

In this section, we will focus on the role of the actuarial function under the Takaful framework and how it differs from the role of actuaries under the conventional form of insurance.

PRODUCT DESIGN AND PRICING

Product design under Takaful must be approved by the company's Shari'ah Board ensuring that the design is in compliance with the applicable Shari'ah standards.

As for the pricing of the products, the approach is similar to that of pricing any product under conventional insurance where a risk premium is determined based on historical claims experience or reinsurer prescribed risk premium rates are to be followed. Once cell-level risk premium rates are assessed, the key difference is with respect to the loadings applied. Under conventional insurance, the risk premium rates are loaded up to reflect the expenses, commissions, and profit margins; however, under the Takaful framework, the aggregate loading is in the form of the wakala being levied on the participants' fund. The two approaches can be formulaically expressed as follows:

CONVENTIONAL

$$\text{Gross Premium} = \frac{\text{Net Risk Premium}}{1 - \text{Expense Loading (\%)} - \text{Actual Commission (\%)} - \text{Profit Margin (\%)}}$$

TAKAFUL

$$\text{Gross Contribution} = \frac{\text{Net Risk Contribution}}{1 - \text{Wakala Loading (\%)}}$$

The approach is similar when pricing long-term individual life products where wakala is treated as a charge to the participants' fund which, in turn, covers expenses and commissions borne by the shareholders' fund. The excess of wakala over and above the expenses and commissions paid is the profit to the shareholders.

RESERVING

The table below presents a comparison of different reserves held within each fund under the Takaful framework compared with those maintained in conventional insurance.

Table 22

COMPARISON OF RESERVES HELD UNDER CONVENTIONAL INSURANCE AND TAKAFUL

	CONVENTIONAL INSURANCE ⁴	PARTICIPANTS' FUND	SHAREHOLDERS' FUND
Premium Reserve – Short-term	Unearned Premium Reserve	Unearned Risk Contribution Reserve	Unearned Wakala Reserve
Premium Reserve – Short-term	Premium Deficiency Reserve	Risk Contribution Deficiency Reserve	Not Applicable
Premium Reserve – Long-term	Mathematical Reserve ⁵	Mathematical Reserve ⁶	Unearned Wakala Reserve
Claims Reserve	Reported Claims	Reported Claims	Not Applicable
Claims Reserve	Unreported Claims	Unreported Claims	Not Applicable
Expense Reserve	Expense Reserve	Not Applicable	Not Applicable ⁷

The unearned wakala reserve held within the shareholders' fund is not usually a prescribed requirement from the regulatory authorities given the actual extent of expenses and commissions is well known in advance. However, as a best practice, it is recommended that shareholders hold an unearned wakala reserve.

In essence, under the Takaful framework, specifically when operating under either the Wakala or Hybrid Model, Unearned Premium Reserve is held in two parts – the portion of the gross contribution, which is expected to cover future benefits within the participants' fund held as an unearned risk contribution reserve, whereas the portion expected to cover expenses and commissions within the shareholders' fund is held as an unearned wakala reserve.

A similar approach is followed in the case of long-term Takaful contracts where the mathematical reserve under the Takaful framework is assessed only for the participants' fund taking the risk contribution (net of wakala fee) as an inflow and benefits as an outflow. An alternative approach could be to take the gross contribution as an inflow and wakala fee and benefits as an outflow.

⁴ Applies to Mutuals, as well as the Cooperative Model, under the Takaful framework

⁵ Held to cover future expected claims

⁶ Held to cover future expected benefits

⁷ Unearned Wakala serves as an expense reserve under the Shareholders' Ffund

The premium deficiency reserve under the Takaful framework is only assessed on the participants' fund. The following formulaic expressions are helpful for a clear understanding:

CONVENTIONAL

$$\text{Premium Deficiency Reserve} = \text{Projected Outflows (Claims + Expenses + Commissions)} - \text{Projected Inflows (Unearned Premiums)}$$

TAKAFUL

$$\text{Contribution Deficiency Reserve} = \text{Projected Outflows (Claims)} - \text{Projected Inflows (Unearned Risk Contributions)}$$

Given the participants' fund is only expected to cover benefits, a contribution deficiency reserve is recommended when the held unearned risk contribution reserve is insufficient to cover future expected benefit payments.

Claim reserves, either reported or unreported, follow the same practice under all forms of insurance. There's a general concern for new Takaful operators with respect to the lack of historical data and challenges around adequate pricing and reserving of Takaful contracts held. Given the lack of benchmarks, it is advisable to use benchmarks from the conventional counterparts given the loss experience is largely the same and varies only with the underwriting practices being followed, assuming both the Takaful operator and its conventional counterpart are operating in the same jurisdiction.

ENHANCED ROLE OF ACTUARIES UNDER THE TAKAFUL FRAMEWORK

Apart from the traditional role of actuaries in the insurance industry, in certain jurisdictions, Appointed Actuaries for Takaful operators are also required to advise on the following aspects:

- Reviewing Investment Policy of the Participants' fund – including carrying out an asset-liability matching exercise.
- Advise on the basis of surplus distribution.
- Review and advise on the operators' policy of determining the wakala and mudaraba charges.

Section 5: Retakaful

Retakaful serves as a Shari'ah-compliant reinsurance framework, mirroring conventional reinsurance practices, but rooted in the principles of collective support and voluntary contributions. In this cooperative system, participants unite to collectively shoulder risks. There are two primary forms of Retakaful: treaty and facultative. Treaty Retakaful involves a formal agreement between a Takaful operator and a Retakaful operator to cover specific business categories, while Facultative Retakaful focuses on covering specific risks through an arrangement between the two operators.

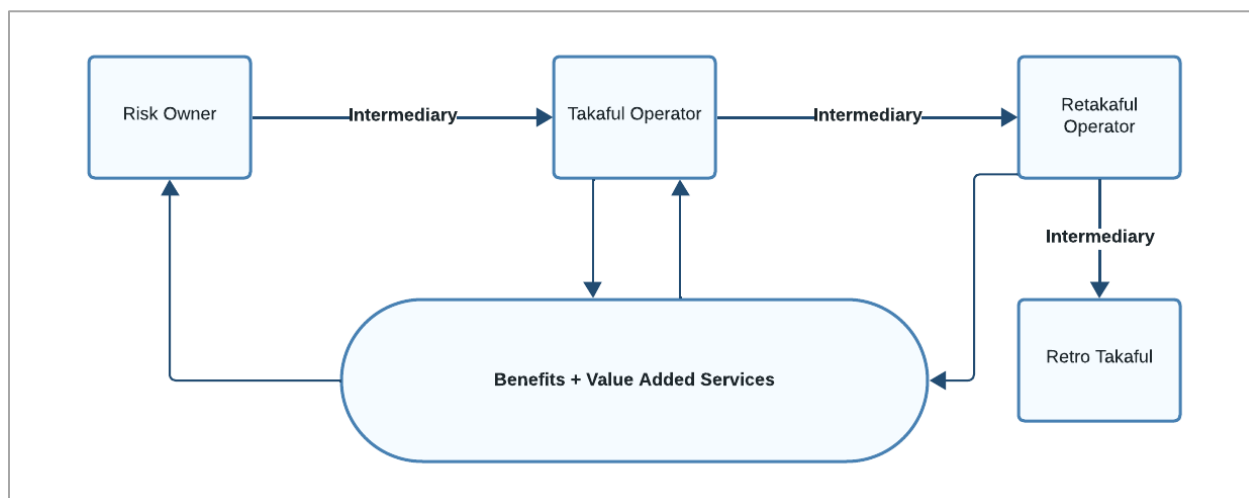
Apart from risk-sharing, Retakaful operators provide various services, including underwriting, claims management, training, product innovation, and risk control. This comprehensive support helps Takaful operators establish and maintain their operations, similar to conventional reinsurance counterparts.

The prominence of Retakaful is on the rise in the insurance sector, with an increasing number of enterprises offering comprehensive solutions to Takaful operators globally. This trend highlights the growing recognition of Retakaful's value within Shari'ah-compliant practices.

By adhering to ethical principles and avoiding interest-based transactions, Retakaful demonstrates a commitment to ethical conduct that aligns with the well-being of society. In essence, it serves as a cornerstone in Islamic finance, strengthening Takaful operators against risks and safeguarding the entire industry's stability (Salman et al., 2014).

Figure 7

RISK CIRCULATION (GÖNÜLAL, 2012)



5.1 THE NEED FOR RETAKAFUL

Retakaful is imperative for Takaful operators as it serves as a fundamental risk management strategy. By sharing a portion of risk with external entities, Takaful operators can diversify their risk exposure, ensuring that they are not overly concentrated in specific types of risks.

In essence, Retakaful serves as a strategic tool for Takaful operators, offering them financial stability, risk management support, and the ability to navigate a dynamic and challenging insurance landscape. Discussed below are some of the objectives Takaful operators seek to achieve from Retakaful arrangements:

- **Diversification of Risks:** Allows operators to spread risk across a broader spectrum, reducing exposure to concentrated risks.
- **Capacity Enhancement:** Access to additional capacity beyond the operator's own financial resources. This is particularly beneficial for operators when dealing with large and complex risks.
- **Financial Stability:** Provides an additional layer of financial security, ensuring the operator's ability to meet its obligations and maintain solvency.
- **Technical Expertise and Support:** Access to valuable insights into risk management, underwriting practices, and claims handling from experienced Retakaful partners.
- **Facilitating Expansion:** Provision of support and risk-sharing mechanisms to operators for expansion into newer markets, enabling them to enter regions with diverse risk profiles.
- **Regulatory Compliance:** Helps Takaful operators meet regulatory requirements, as some jurisdictions mandate a certain level of risk-sharing through Retakaful arrangements.
- **Catastrophe Coverage:** Offers a crucial layer of protection against large-scale catastrophes, ensuring that the Takaful operator can effectively manage and cover losses arising from such events.
- **Shari'ah Compliant:** Ensures that the risk-sharing practices align with Shari'ah principles, providing a framework for ethical and Shari'ah-compliant risk management.

5.2 RETAKAFUL WINDOW

Well-capitalized conventional reinsurers can diversify their services by offering Retakaful services in addition to their primary reinsurance operations. This expansion is facilitated through a dedicated channel known as a Retakaful Window. To ensure compliance with Shari'ah Law, it is imperative for conventional reinsurers to maintain a clear segregation of operational activities between their conventional and Retakaful segments. The Retakaful window must strictly adhere to the prerequisites of Islamic finance. A notable example is ZEP Re (PTA Reinsurance Company), which extends Retakaful services into Africa through its specialized Retakaful window located in Sudan.

5.3 RETAKAFUL COMPANIES

Prominent providers of Shari'ah-compliant Retakaful services include Swiss Re Retakaful, Munich Re Retakaful (MRR), and RGA Retakaful. Swiss Re Retakaful adopted a risk-sharing model, distributing risks among participants to offer a comprehensive range of services. Operating globally from Kuala Lumpur, Munich Re Retakaful, a subsidiary of Munich Re, specializes in innovative and Shari'ah-compliant Retakaful solutions for both general and family segments. Based in the USA, RGA Retakaful provides diverse Retakaful solutions worldwide, emphasizing mutual assistance and voluntary contributions. These companies, equipped with expertise in risk management, underwriting, and claims services, play pivotal roles in supporting the global Takaful and Retakaful markets.

The Retakaful industry faces distinctive challenges compared to traditional reinsurance, attributed to its relatively smaller size and ongoing efforts to expand globally. Challenges include enhancing capacity for large risks and new products, navigating complexities in surplus distribution, addressing ownership concerns of the Retakaful

contribution fund, ensuring the availability of Retakaful alternatives, and defining the nature of risk-sharing versus risk transfer. Overcoming these obstacles necessitates innovation, regulatory clarity, and collaborative efforts to fortify the Retakaful sector, ensuring sustained and meaningful growth (Gönülal, 2012).

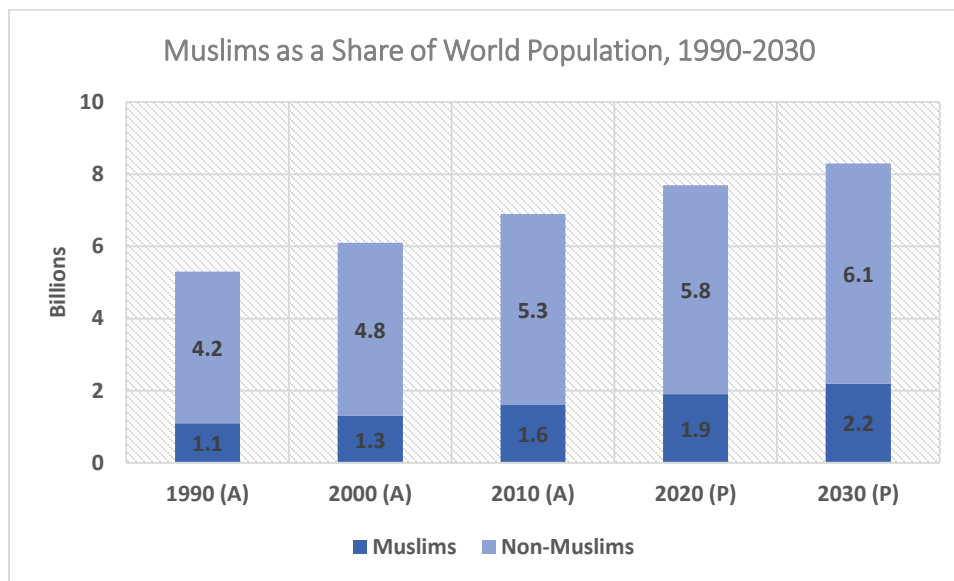
Section 6: Rationalizing Takaful's Global Adoption

Adopting Takaful in its truest form, and overcoming the obstacles posed by policymakers and regulators, may present challenges. The Takaful industry confronts various well-known hurdles that could impede its expansion and hinder its widespread acceptance in the global market. Nevertheless, a meticulous examination of the untapped Muslim population segment on the international stage and the opportunities inherent within the Takaful framework might outweigh the risks linked to fully embracing this framework.

6.1 UNTAPPED MUSLIM POPULATION

The worldwide Muslim population, representing about 23.4% of the global populace in 2010, is projected to reach 2.2 billion by 2030, accounting for approximately 26.4% of the world's population. As the second-largest global religion, Islam has a significant presence, with 44.1 million Muslims in Europe and 5.2 million in the Americas as of 2010. It's worth noting that roughly 58% of the Muslim population in the Americas consists of immigrants who, despite having easy access to Islamic financial products in their native countries, may encounter challenges in accessing such products or services post-immigration to Western countries. This creates a substantial demand for ethical insurance solutions (Pew Research Centre).

Figure 8
MUSLIMS AS A SHARE OF WORLD POPULATION



(Source: The Future of the Global Muslim Population, January 2011, Pew Research Centre)

Table 23
MUSLIM POPULATION BY REGION

	2010		2030	
	Estimated Muslim Population	Estimated Percentage of Global Muslim Population	Projected Muslim Population	Projected Percentage of Global Muslim Population
World	1,619,314,000	100.00%	2,190,154,000	100.00%
Asia-Pacific	1,005,507,000	62.09%	1,295,625,000	59.16%
Middle East-North Africa	321,869,000	19.88%	439,453,000	20.06%
Sub-Saharan Africa	242,544,000	14.98%	385,939,000	17.62%
Europe	44,138,000	2.73%	58,209,000	2.66%
Americas	5,256,000	0.32%	10,927,000	0.50%

(Source: The Future of the Global Muslim Population, January 2011, Pew Research Centre)

In the quest for a more inclusive and socially responsible insurance landscape, the adoption of Shari'ah-compliant products holds significant promise. Insurers, by steering clear of interest-based transactions and unethical investments, can cultivate trust and establish enduring connections with customers, securing a competitive edge in a specialized market. Drawing inspiration from the Takaful framework, insurance companies in the Western world may find avenues for enhanced market penetration, offering ethical insurance products to a vast Muslim customer base. A notable practice, Window Takaful, involves traditional insurers diversifying services by providing Takaful products alongside conventional offerings, catering to customers seeking Shari'ah-compliant insurance (Hassan & Abbas, 2019).

6.2 INCLUSIVITY AND SOCIAL SOLIDARITY

In a world grappling with economic inequality and environmental challenges, Takaful fosters a sense of social solidarity and mutual support. By integrating these principles into business models, insurance companies in the western markets can reinforce their corporate social responsibility efforts and demonstrate a commitment to ethical practices that extend beyond mere profit-making motives. Based on the concept of cooperation and shared responsibility, Takaful tends to foster a sense of social solidarity amongst investing members who contribute to a common pool to support those in need. This can promote a more inclusive insurance system, especially in communities where traditional insurance might be inaccessible or less prevalent (Hassan & Abbas, 2019).

6.3 DIVERSIFIED INVESTMENT PORTFOLIOS WITH ETHICAL ASSETS

One of the major concerns associated with conventional insurance amongst the Muslim population in the Western markets is the risk of their investments being made into unethical ventures. The Takaful framework addresses this by encouraging insurers to diversify investment portfolios with ethical assets, contributing to a more sustainable and socially responsible world. This not only mitigates risks associated with traditional investments, but also taps into untapped markets in the Islamic financial sector, attracting socially conscious investors (Qian & Darman, 2023).

6.4 CROSS-CULTURAL UNDERSTANDING AND COLLABORATION

The cross-pollination of ideas between Islamic and conventional finance can foster relationships between companies and potential customers, leading to the development of hybrid models that combine the best aspects of both systems, and ultimately result in penetration of an untapped population segment. Such innovation may

foster financial products that not only adhere to Islamic principles, but also cater to broader ethical and social responsibility considerations. This creative synthesis can bring about financial solutions that benefit individuals and businesses alike, irrespective of their cultural or religious backgrounds (Qian & Darman, 2023).

6.5 RISK-SHARING AND FAIRNESS

The Takaful framework's essence lies in risk-sharing, promoting equality and fairness among policyholders. When participants share the costs of claims, the system reinforces the principles of equality. Adopting the Takaful framework can help conventional insurers attract individuals and businesses actively seeking Islamic financial solutions, achieving better market diversification (Hassan & Abbas, 2019).

6.6 REGULATION AND CONSUMER PROTECTION

Regulation plays a crucial role in formalizing the Takaful industry, ensuring adherence to strict standards for consumer protection and market confidence. While the Takaful framework offers advantages, its adoption requires careful consideration of regulatory requirements and a thorough understanding of Islamic financial principles for a harmonious business process between providers and consumers (Hassan & Abbas, 2019).

Section 7: Shari'ah Supervisory Board

A Shari'ah Supervisory Board (SSB) is a vital component in an Islamic financial institution comprising distinguished religious scholars well-versed in Islamic jurisprudence, specifically regarding financial transactions. The primary role of the board is to assess and affirm the alignment of activities conducted by an Islamic financial institution with the principles of Shari'ah law.

Moreover, the board's responsibility extends to ensuring that the Islamic financial institution under its purview conducts financial operations in accordance with the ethical guidelines outlined by Shari'ah principles (Abdul Rahman et al., 2004).

As per the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the SSB is an independent body consisting of jurists with specialized religious knowledge. This body is entrusted with the task of directing, guiding, checking, reviewing, and overseeing the financial operations of Islamic Financial Institutions (IFI) to ensure Shari'ah compliance.

7.1 ROLES AND RESPONSIBILITIES OF THE SHARI'AH SUPERVISORY BOARD

The Shari'ah Supervisory Board (SSB) plays a crucial role in the context of Takaful, ensuring that the operations and practices of Takaful operators adhere to Islamic principles and Shari'ah law. The responsibilities of the SSB are multifaceted, encompassing both pre-auditing and post-auditing functions to guarantee compliance (Briston & El-Ashker, 1986).

In the pre-auditing phase, the SSB is responsible for formulating review procedures tailored for adoption by Takaful operators. These procedures are designed to assess and evaluate the Shari'ah compliance of various aspects of Takaful operations, including product structures, investment activities, and underwriting practices. The aim is to establish a robust framework that aligns with Islamic finance principles and safeguards the interests of participants. This pre-emptive role ensures that Takaful products and processes are developed in accordance with Shari'ah guidelines from their inception.

In the post-auditing phase, the SSB performs rigorous review procedures, involving a thorough examination of working documents related to Takaful operations. This includes scrutinizing financial transactions, investment portfolios, and underwriting practices to ensure that they remain in compliance with Shari'ah principles. The SSB records its findings and generates comprehensive reports detailing the outcomes of the review process. These reports serve as a transparent mechanism to communicate the Shari'ah compliance status of the Takaful operations to stakeholders, including participants and regulatory authorities.

This oversight by the SSB provides a robust framework for ethical and Shari'ah-compliant Takaful operations (Billah & Daud, 2015).

7.2 SSB AND CORPORATE GOVERNANCE ISSUES

While the Shari'ah Supervisory Board (SSB) plays a crucial role in aligning the operations of financial institutions with Islamic finance principles, it introduces five significant corporate governance issues: independence, transparency, confidentiality, consistency, and disclosure.

The foremost concern centers around the independence of SSB members regarding the institution's management. As these members are appointed by shareholders and report to the Board of Directors, a potential conflict arises due to their dual role as evaluators and employees. This dual relationship can compromise their impartiality, especially when their judgment opposes financially beneficial yet non-compliant transactions. Management might exert influence to sway the opinion of SSB members in such cases.

The issue of confidentiality emerges when Shari'ah scholars sit on multiple financial organizations' boards. While this might enhance their independence, it poses a risk of breaching confidentiality. Consistency of judgment across institutions and jurisdictions is another crucial matter. Although jurisprudence is used to interpret the law, any conflict in opinions among jurists questions the acceptability and authenticity of financial matters. Notably, global surveys show a high level of concordance among jurists.

The final concern is the disclosure of information about Shari'ah advisories. While complete transparency enhances stakeholders' confidence, it also brings potential issues to light. However, if concerns regarding independence, confidentiality, and consistency are addressed, transparency becomes a valuable tool for educating the public, positively impacting cost implications, credibility assessment, and building confidence in Shari'ah compliance (Grais and Pellegrini, 2006).

Transitioning from these challenges, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) plays a pivotal role in establishing comprehensive standards that govern various aspects of Islamic finance, including Shari'ah compliance, accounting, auditing, and governance. AAOIFI has diligently developed and published a total of 59 Shari'ah standards, 33 accounting standards, 8 auditing standards, 14 governance standards, and 3 standards on ethics. These standards collectively form a framework to ensure the adherence of Islamic financial institutions (IFIs) to Shari'ah principles, while promoting transparency, accountability, and sound governance practices.

Among the plethora of standards, those pertaining to governance hold particular significance in enhancing corporate governance within Islamic financial institutions. The governance standards set by the AAOIFI encompass crucial aspects, such as the appointment and composition of Shari'ah Supervisory Boards (SSBs), review procedures, and the independence of SSBs. These standards are instrumental in addressing corporate governance issues by providing clear guidelines on the establishment and functioning of SSBs, which play a pivotal role in ensuring Shari'ah compliance.

7.3 ENHANCING SSB PROFICIENCY AND SHARI'AH COMPLIANCE

Ensuring the effectiveness of Shari'ah Supervisory Board (SSB) members and Shari'ah reviewers demands a comprehensive strategy. Immediate actions to elevate the expertise of Shari'ah advisors may involve implementing targeted training initiatives focused on Islamic transactions and commercial law within the Islamic financial institutions. Collaborations with specialized training institutions and partnerships with government-authorized bodies, such as central banks, could be instrumental in this effort.

The development and promotion of academic programs concentrating on Islamic transactions and commercial law, supported by funding and official university endorsements, would further strengthen proficiency. Simultaneously, a certification process would formally acknowledge the skills of Shari'ah advisors and reviewers.

To ensure transparency and accountability, the professional backgrounds of SSB members should be readily accessible to the public through platforms like websites and annual reports. Consistent prerequisites at a national level could be enforced by self-regulatory bodies or national authorities, fortifying the overall certification process.

Similarly, a nationwide registration system, modeled after Malaysia's Association of Shari'ah Advisors in Islamic Finance (ASAS), could be established. This approach not only ensures competency, but also fosters increased independence in Shari'ah audit processes (Grais and Pellegrini, 2006).

Recognizing the pivotal role of Shari'ah Supervisory Boards (SSB) in fostering good governance within the Islamic financial institutions, it is imperative to grant them maximum independence in their supervisory capacity to

eliminate perceived differences between Islamic Financial Institutions (IFIs) and SSB members. Despite these efforts, variations in interpretation and conclusions may still arise among scholars sitting on different SSBs appointed by IFIs within a country.

To ensure a unified interpretation, it is recommended that SSBs be centralized at the national level. This centralized approach has proven effective in countries like Iran, where the Council of Guardians oversees and guarantees Shari'ah compliance of the entire financial sector. In a similar vein, Indonesia's National Shari'ah Council (NSC), an extension of the National Ulama Council, possesses the authority to issue clarifications on various financial matters.

By consolidating the functions of SSBs at the national level, a standardized framework for Shari'ah compliance can be established, mitigating the risk of divergent interpretations. This model, already successfully implemented in certain jurisdictions, ensures consistency and oversight, contributing to the overall effectiveness and credibility of Shari'ah governance within the financial sector.

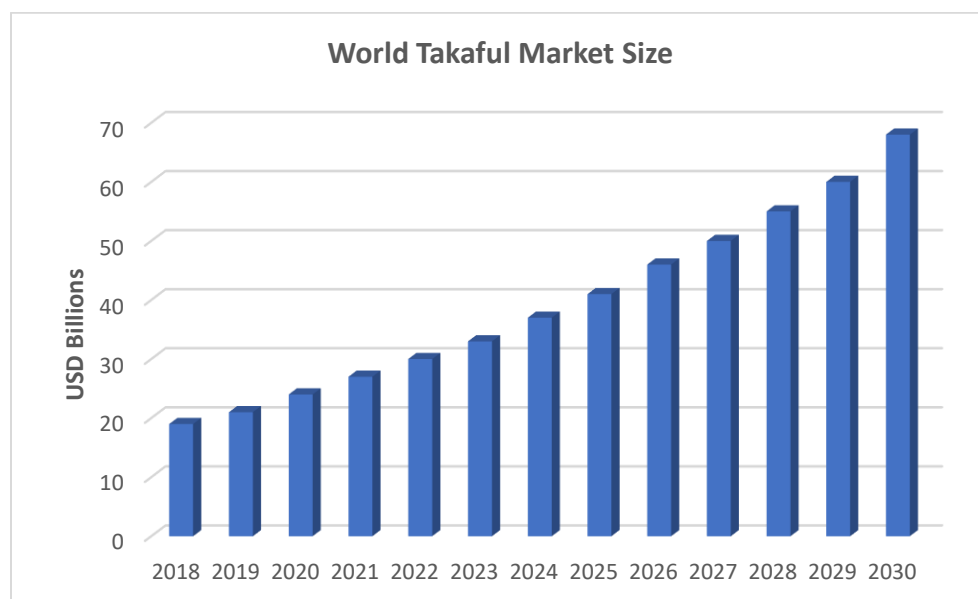
Section 8: Global Expansion and Barriers: Takaful Growth in Key Markets and Challenges Ahead

The Takaful market has been developing steadily in recent years, especially in Muslim-majority countries and regions. According to various sources, the global Takaful market exhibited remarkable growth, reaching approximately USD 30 billion in 2022 (USD 19 billion in 2017). This expansion is attributed to several factors: escalating demand for Shari’ah-compliant financial services among the world’s substantial Muslim population, especially in the GCC and Southeast Asia; untapped opportunities due to the limited presence of traditional insurance in many Muslim nations; appealing ethical aspects resonating with both Muslim and non-Muslim clientele, such as fairness and transparency; and innovative, diversified Takaful offerings addressing various customer needs like family, general, health, and education takaful.

Forecasts predict a continuous upward trajectory with a projected 10.2% compound annual growth rate during 2023-2028, potentially reaching USD 54.9 billion by 2028. This growth will be driven by factors such as increasing awareness in emerging markets, supportive regulatory measures, collaborative efforts within the industry, and the integration of digital solutions for operational efficiency, customer service enhancement, and product innovation (Raj & Kumar, 2021).

Figure 9

HISTORICAL AND FORECASTED VALUES OF THE GLOBAL TAKAFUL MARKET FROM 2018 -2030



8.1 TAKAFUL IN SELECT GCC AND ASIAN COUNTRIES

This subsection offers insights into the dynamics of the insurance industry across selected GCC and Asian countries from 2020 to 2022, paralleling the regulatory discourse highlighted in Section 3. It delves into the number of listed insurers and Takaful operators, as well as examining the proportion of Takaful contributions against traditional insurance premiums for each selected country.

The tabulated data presents the landscape of conventional and Takaful companies in Bahrain, the KSA, Malaysia, Pakistan, and the UAE. Notably, the KSA dominates the Takaful market, with Pakistan following closely behind in terms of the listed Takaful operators.

Table 24**CONVENTIONAL & TAKAFUL COMPANIES IN SELECT GCC AND ASIAN COUNTRIES – 2022**

COUNTRY	CONVENTIONAL	TAKAFUL	TOTAL
Bahrain	3	2	5
KSA	-	27	27
Malaysia	34	16	50
Pakistan	21	19	40
UAE	21	7	28
Total	79	71	150

The table illustrates the count of listed reinsurers and Retakaful operators across the five chosen countries. Among the 150 listed companies, 71 are designated as either Takaful or Retakaful operators. Notably, in the Kingdom of Saudi Arabia, insurers adhere to the cooperative model mandated by the regulatory authority, rendering conventional insurers absent in the Kingdom. This highlights the KSA's prominence, boasting the highest number of Takaful operators, with Pakistan following closely as the second-largest hub.

Analyzing revenue trends over the three-year span reveals Malaysia's robust performance, leading in annual insurance/Takaful revenues. The KSA emerges as the most prominent Takaful market in the GCC and globally, showcasing substantial growth.

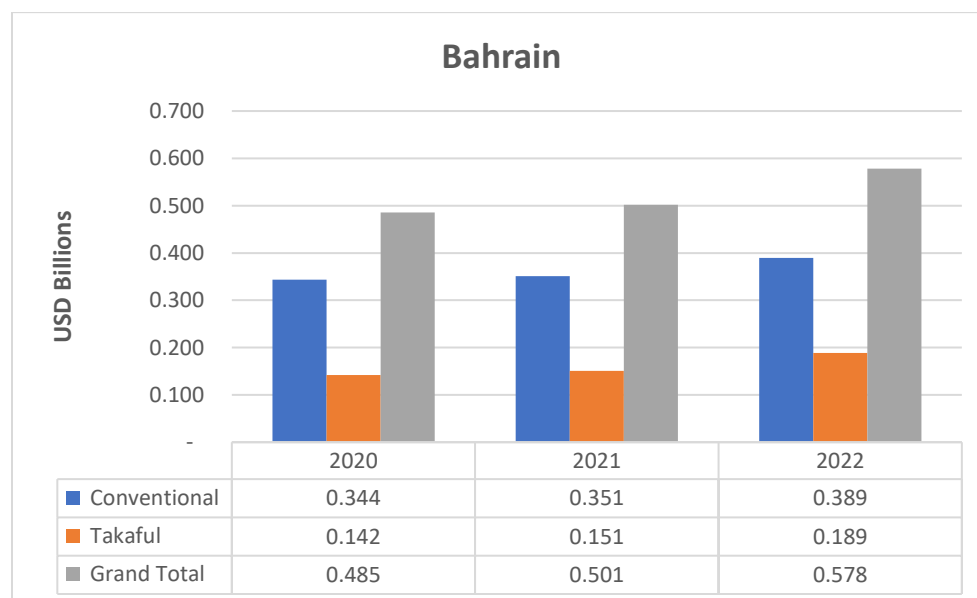
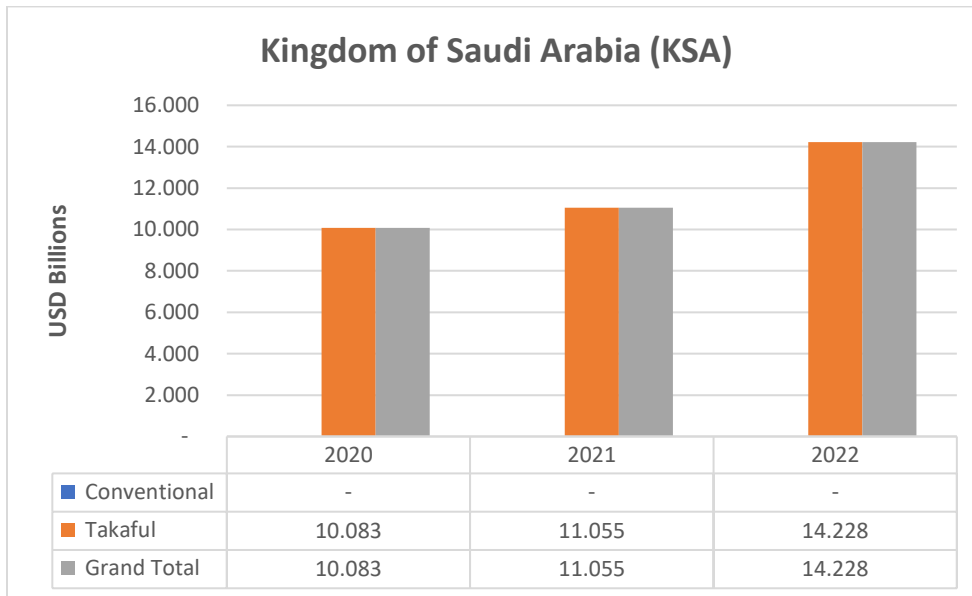
Figure 10**CONVENTIONAL & TAKAFUL REVENUES IN BAHRAIN – 2020-2022**

Figure 11

CONVENTIONAL & TAKAFUL REVENUES IN THE KINGDOM OF SAUDI ARABIA (KSA) – 2020-2022

**Figure 12**

CONVENTIONAL & TAKAFUL REVENUES IN MALAYSIA – 2020-2022

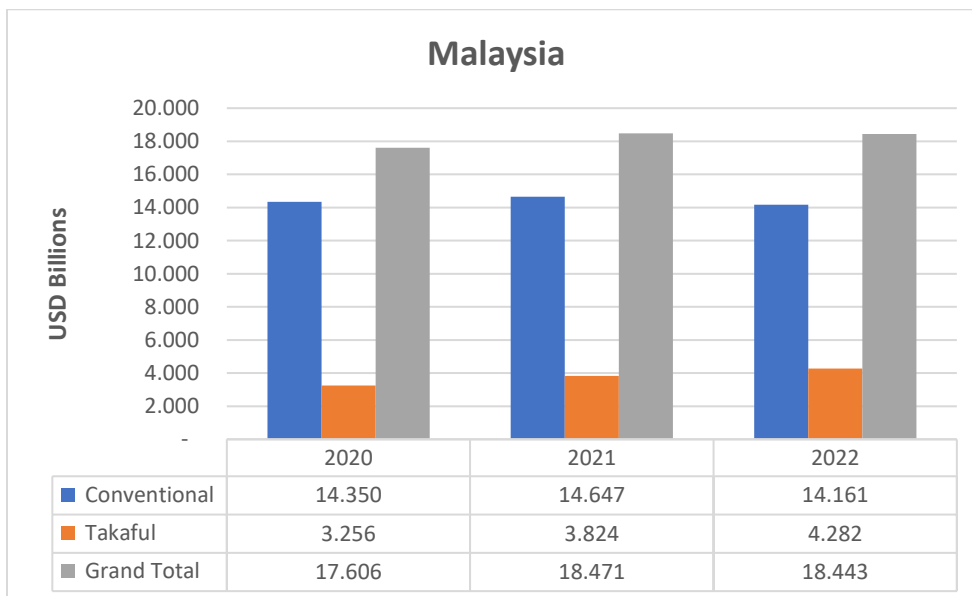


Figure 13
CONVENTIONAL & TAKAFUL REVENUES IN PAKISTAN – 2020-2022

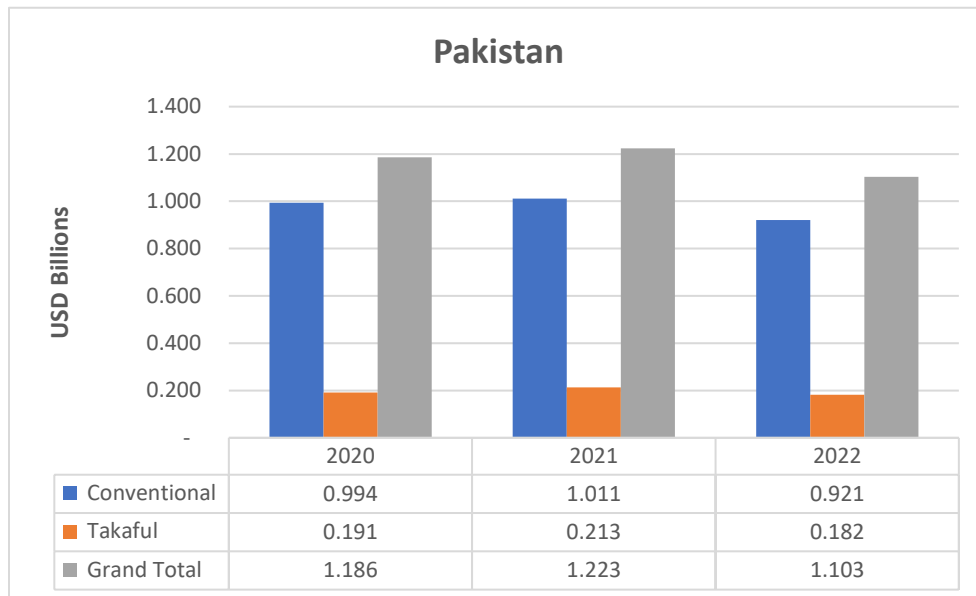
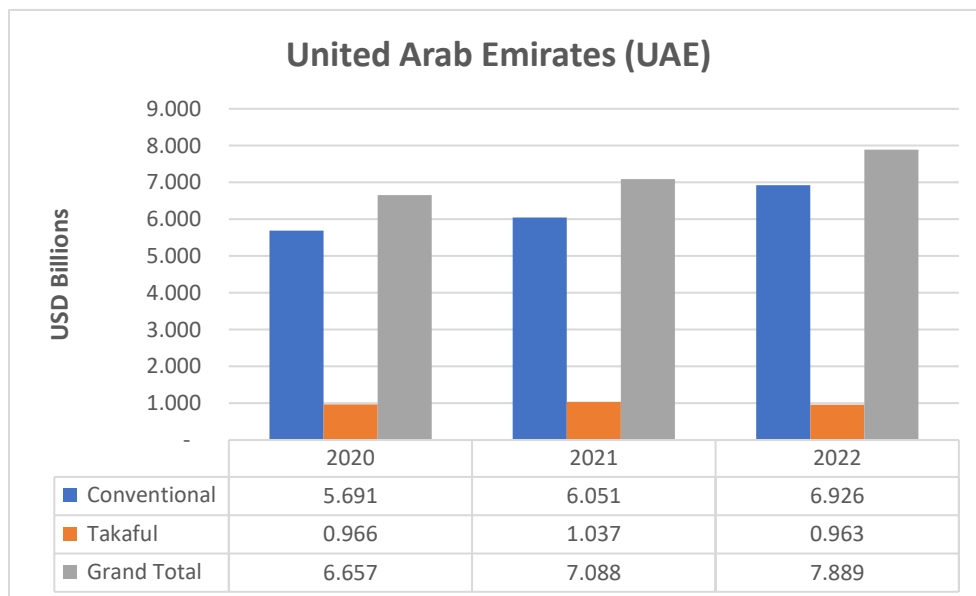


Figure 14
CONVENTIONAL & TAKAFUL REVENUES IN THE UNITED ARAB EMIRATES (UAE) – 2020-2022



Across the examined countries, Malaysia leads in annual insurance/Takaful revenues. Notably, the KSA emerges as the largest Takaful market globally. In 2021, the growth in Takaful contributions outpaced the growth in conventional premiums, with significant growth observed in Malaysia and Pakistan. In 2022, while the KSA experienced remarkable growth, Malaysia saw substantial growth in Takaful contributions despite a negative growth in conventional premiums.

Table 25
GROWTH IN CONVENTIONAL & TAKAFUL REVENUES IN SELECTED GCC AND ASIAN COUNTRIES

GROWTH – 2021/2020			
COUNTRY	CONVENTIONAL	TAKAFUL	TOTAL
Bahrain	2.09%	6.41%	3.35%
KSA	0.00%	9.65%	9.65%
Malaysia	2.07%	17.44%	4.91%
Pakistan	1.68%	11.01%	3.18%
UAE	6.32%	7.36%	6.47%
Total	3.18%	11.22%	6.45%

GROWTH – 2022/2021			
COUNTRY	CONVENTIONAL	TAKAFUL	TOTAL
Bahrain	10.87%	25.05%	15.13%
KSA	0.00%	28.86%	28.86%
Malaysia	-2.92%	12.42%	0.26%
Pakistan	0.70%	-5.22%	-0.33%
UAE	14.33%	-7.27%	11.17%
Total	2.20%	22.22%	10.70%

In 2021, aggregate Takaful contributions for the selected countries surged by 11.22%, outpacing the modest 3.18% increase in conventional revenues. Notably, the Kingdom of Saudi Arabia (KSA) experienced significant growth, with Takaful contributions soaring by 9.65%. Across all selected countries, Takaful contributions exhibited robust growth, surpassing that of conventional premiums. Malaysia and Pakistan stood out with remarkable growth rates of 17.44% and 11.01%, respectively, while conventional premiums lagged behind at 2.07% and 1.68%, respectively.

In 2022, aggregate revenues across the five countries surged by 10.70%, driven by substantial growth in the KSA at 28.86%. Malaysia saw nominal growth in insurance revenues, yet Takaful contributions surged by 12.42%, while conventional premiums plummeted by 2.92%. Pakistan experienced a nominal decline of 0.33% in overall revenues, largely due to currency devaluation. However, in local currency terms, Pakistan's insurance/Takaful revenues witnessed an approximate 15% annual growth from 2020 to 2022.

Takaful contributions in 2022 showcased remarkable growth of 22.22%, compared to conventional premiums' modest 2.20% increase. Notably, the UAE and Pakistan experienced negative growth in Takaful contributions, contrasting with positive growth in conventional premiums. This downturn in Takaful contributions can be attributed to a combination of factors, including insolvencies among the UAE Takaful operators and regulatory pressure to consolidate. In response to financial strains and regulatory scrutiny, several Takaful operators faced challenges and were compelled to consider consolidation strategies, such as selling or merging with larger players in the industry. These developments underscore the complexity and competitive landscape of the Takaful sector, prompting a reassessment of business models and regulatory frameworks to ensure long-term sustainability and resilience.

8.2 IMPEDIMENTS TO TAKAFUL PENETRATION

While Takaful is gaining a respectable momentum in the GCC and other Asian regions, its awareness, penetration and potential adoption in the Western markets remain uncertain. Frequently mistaken for mutual funds, Takaful, as a form of ethical insurance, is still an anomalous concept for many Western insurance companies, impeding its worldwide expansion. Several barriers obstruct its progress:

8.2.1 LACK OF KNOWLEDGE AND COMPREHENSION OF TAKAFUL

The concept of Takaful and its principles remain unfamiliar to many individuals, including both Western consumers and insurance companies. This lack of familiarity may lead to limited promotion on suitable platforms, misunderstandings regarding Takaful's concepts, or a general reluctance to engage with Islamic finance products. Some perceive Takaful merely as a variation of conventional insurance within an Islamic framework and question its adherence to Shari'ah principles. Others underestimate its financial security, relying instead on traditional social security systems. Overcoming these challenges necessitates educational initiatives aimed at enhancing comprehension of Takaful and promoting individual risk management practices within Muslim and non-Muslim communities alike. Presently, Takaful education predominantly targets practitioners and investors, with minimal efforts directed towards broader awareness campaigns among the intended audience (Unwin et al., 2010).

8.2.2 REGULATORY CHALLENGES AND LACK OF STANDARDIZATION

The regulatory framework presents significant challenges for Takaful operations, particularly in Western jurisdictions where regulations are primarily designed for conventional insurance models. Integrating Takaful concepts into Western financial reporting frameworks is intricate and time-consuming, often yielding unreliable outcomes. This complexity not only impedes cross-border business endeavors and product innovation, but also complicates compliance efforts. The lack of standardized regulations further constrains market expansion and hampers the overall advancement of the Takaful industry. Takaful entities must navigate a plethora of regulatory requirements, eroding consumer trust and hindering the potential for operational efficiency and uniformity (Saeed, M., 2019).

To address these issues, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has developed and issued 117 standards and technical pronouncements. These aim to harmonize and standardize financial reporting for Takaful and Retakaful operators, ensuring compliance with Shari'ah principles.

8.2.3 CHALLENGES FROM CULTURAL AND REGIONAL DISCREPANCIES

Negative perceptions surrounding Takaful have emerged due to limited awareness and misunderstandings about Islamic Finance. Variations in the interpretation of Islamic principles influence how potential clients perceive Takaful's adherence to them. Misconceptions arising from a lack of understanding of cultural nuances can breed distrust. To address these challenges effectively, it is imperative to implement strategies, such as refining product offerings, employing robust communication methods, and fostering a culture of transparency. Enhancing awareness of how the Takaful framework aligns with principles of ethical finance is crucial for removing barriers associated with cultural and religious perceptions (Nabi & Rahman, 2019).

8.2.4 THE LACK OF SHARI'AH EXPERTS WITH THE NECESSARY QUALIFICATIONS

The establishment of a Shari'ah Supervisory Board, typically comprising three or more experts, is a prerequisite for every Takaful operator. Preference is often given to board members with regional expertise when Takaful companies seek expansion, enhancing their credibility. These scholars bear the responsibility of ensuring Shari'ah compliance, necessitating a deep understanding of both Takaful operations and Islamic law. However, the scarcity of experts proficient in both Islamic law and insurance leads to a situation where these scholars serve on multiple boards, potentially resulting in conflicts of interest and diminished advisory quality. Moreover, the limited

availability of such scholars elevates the cost of establishing a Shari'ah board, posing a temporary barrier for new entrants into the Takaful market (Unwin et al., 2010).

8.2.5 WAKALA LEVIES AND COST OF CAPITAL

The challenges stemming from wakala levies and capital costs profoundly affect the financial sustainability and operational efficiency of Takaful operators. Elevated wakala fees possess the potential to reduce participants' contributions and undermine competitiveness in the market. Moreover, since commissions are deducted from the shareholders' fund and wakala fees, in specific jurisdictions, may be subject to regulatory limits, Takaful operators face constraints in competing with conventional insurers. Takaful operators must ensure that commissions fall within the maximum wakala levied, ensuring surplus wakala remains to cover operating costs and yield profit margins for the shareholders, a limitation not imposed on conventional insurers. Therefore, achieving a delicate equilibrium between covering expenses and offering competitive returns to both participants and shareholders is essential. Maintaining a competitive edge and ensuring operational efficiency are paramount, as high fees can deplete the profitability of participants' funds. Given that the cost of capital profoundly influences investment strategies and overall financial performance, a meticulous approach that prioritizes participants' interests, complies with legal requirements, and ensures long-term sustainability is imperative (Ali & Nisar, 2017).

8.2.7 CHALLENGES IN RISK ACCEPTANCE

The acceptability of risk in Takaful presents multifaceted challenges that stem from differing scholarly perspectives and interpretations, particularly evident in General Takaful. Scholars hold varying opinions on the permissible extent of risks, especially concerning mutual guarantee concepts applied to large-scale risks involving limited participants, such as government projects where government agencies are the primary contributors.

Discussions surrounding Takaful risk also grapple with distinguishing between permissible and impermissible risks, emphasizing the need for rigorous risk assessment protocols for inclusion. The absence of standardization further complicates matters, extending to defining insured events and exclusions. In the realm of Family Takaful, disparities emerge in how sensitive issues like suicide, AIDS, and contestability are addressed.

These inconsistencies contribute to the complexity of pricing assumptions and experience pooling, hindering efforts to achieve consistency across Takaful operations with varying underwriting practices and contractual terms. Overcoming these challenges requires concerted efforts to establish standardized frameworks and protocols, promoting transparency and coherence within the Takaful industry.

8.2.8 LACK OF PERMITTED INVESTMENT AVENUES

The challenge of limited investment avenues confronts Takaful operators, who frequently encounter restrictions due to the dominance of interest-bearing instruments in the market. This dilemma is exacerbated by the need to strike a balance between long-term sustainability and short-term profitability. The increasing pressure to mitigate investment risks, driven by the concentration of investments in equity and real estate, presents Takaful companies with an ethical dilemma. Shari'ah laws prohibit certain forms of investments, leading to a lack of available investment avenues for Takaful companies.

Section 9: The Solution - Window Takaful

Amidst the growth of Takaful in the GCC and other Asian countries, coupled with the challenges hindering its expansion, it becomes imperative to devise solutions to the existing obstacles. Takaful's framework stands out for its fairness, particularly evident in its principle of excess sharing among participants, fostering a sense of community ownership. However, a significant hurdle lies in the absence of a standardized financial reporting framework, especially prevalent in many Western countries. Despite this, the absence of such a framework shouldn't preclude the consideration of Takaful operations.

For insurers worldwide, particularly those operating in regions with limited Takaful infrastructure, the concept of Window Takaful presents a practical solution. According to the Islamic Financial Services Board (IFSB), Window Takaful involves establishing a dedicated division within a conventional insurer, referred to as the 'host,' with its own distinct assets and liabilities. This division is separate from the conventional operations and is specifically designed to offer Takaful or Retakaful products.

Window Takaful, prevalent in various Muslim countries like Pakistan and Indonesia, serves as a conduit for expanding into untapped markets. Window operations promote financial inclusion by extending Takaful products to segments of the population previously underserved by conventional insurers. By leveraging the existing infrastructure and market insights of conventional insurers, window operations can efficiently penetrate untapped regions, thereby boosting growth and expansion within the insurance industry.

In Pakistan, for instance, prominent insurers have successfully reached a segment of the population seeking Islamic insurance products by establishing window Takaful operations, facilitated by minimal licensing requirements and lower capital thresholds set by the Security & Exchange Commission of Pakistan. In Indonesia and Turkey, most window operations have evolved into full-fledged Takaful entities. This transition was primarily guided by regulatory directives, as window operations were initially permitted for a limited duration. However, this allowance significantly contributed to the growth of the Takaful industry in these countries and facilitated the development of relevant regulatory frameworks.

Similarly, financial giants in the Middle East, such as Citi, Deutsche, and HSBC, have ventured into the Islamic finance domain through dedicated "Islamic Windows," leveraging their market insights and financial expertise to cater to the growing demand for Islamic products.

In countries where regulators do not provide a financial reporting framework for Takaful operators, such as Sri Lanka, Takaful companies exist and operate with internal financial reporting carried out in line with the standards established by the AAOIFI, while public reporting is carried out in compliance with local regulations. This approach is operationally possible, as shown in Section 4 of this paper, where the amalgamation of Takaful funds produces financial statements closely aligned with conventional financial reporting.

While the establishment of an independent Shari'ah Supervisory Board may come with its own inherent problems, as discussed in Sections 7 and 8 of this paper, particularly due to the scarcity of Shari'ah experts well-versed in Islamic finance principles, for window Takaful operations, there exists a viable avenue for navigating this challenge.

In the absence of a Shari'ah Supervisory Board, guidance and reference can be drawn from the comprehensive Shari'ah standards established by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). These standards serve as a universally recognized framework for ensuring Shari'ah compliance within Islamic financial institutions, offering a roadmap for Takaful operators, including those operating through Takaful windows.

By leveraging the principles outlined by the AAOIFI, window Takaful operations can streamline their compliance efforts and mitigate the complexities associated with establishing an independent Shari'ah Supervisory Board. These standards offer a clear framework for interpreting Shari'ah principles, enhancing transparency and trust in the Takaful sector. Despite the scarcity of Shari'ah experts posing a formidable challenge for Takaful operators, the

utilization of standards established by the AAOIFI presents a practical solution for ensuring Shari’ah compliance, especially within the realm of window Takaful operations in jurisdictions where regulatory guidance around Takaful framework is non-existent. By following these guidelines, Takaful providers can effectively navigate Islamic finance complexities confidently, building trust and promoting ethical insurance practices.

It is also important to note that the Takaful market is on a steady and impressive growth trajectory in recent years, with a particularly strong presence in Muslim-majority countries and regions with market expansion surging from written contributions of USD 19 billion in 2017 to approximately USD 30 billion in 2022. Owing to a significant increase in demand for Shari’ah-compliant financial services, fertile ground waits for conventional insurers to provide Shari’ah-compliant solutions, either through a window or a stand-alone Takaful entity.

Moreover, many underdeveloped nations still have limited traditional insurance offerings, leaving ample room for Takaful to fill this void and tap into previously untapped opportunities. The ethical dimensions of Takaful, including principles of fairness and transparency, have also resonated strongly with both Muslim and non-Muslim customers, further fueling its growth. Takaful providers have innovatively diversified their offerings, catering to a range of customer needs, including family, general, health, and education Takaful. This diversification has contributed to the industry’s resilience and attractiveness.

In summary, Takaful goes beyond mere insurance; it signifies a substantial and ethical shift in the insurance landscape. As we continue to prioritize moral and inclusive financial solutions, Takaful will undoubtedly remain a prominent feature, contributing to our mission of fostering a financially secure and compassionate future for all. As someone who values social responsibility, I perceive Takaful as a refreshing and compassionate insurance alternative. Its emphasis on principles like avoiding interest and uncertainty aligns seamlessly with my core values, ensuring that my insurance decisions reflect my convictions.



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Appendix A: Definitions and Acronyms

AAOIFI: The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) stands as an independent international nonprofit entity. It is dedicated to formulating standards for accounting, auditing, governance, ethics, and adherence to Shari'ah principles within the Islamic financial sector.

Capital Adequacy: Capital Adequacy is to prescribe the capital requirement of a statutory fund to ensure that the obligations to, and reasonable expectations of, policyholders and creditors are able to be met under a range of adverse circumstances, in the context of a viable ongoing operation.

Conventional Insurance: Conventional companies are only subject to the governing laws. Premium paid by the policyholder is considered as income to the company, belonging to the shareholders. All surpluses and profits belong to the shareholders only.

Cooperative Model: The Cooperative Model is a type of Takaful Model and differs significantly from the Hybrid and Wakala models. The financial reporting under this model is more closely aligned with that under mutual or conventional insurance given there's only one fund and Takaful-specific transactions, such as a Wakala fee, Mudarabah fee, or Qard, are non-existent. The only key difference relates to the profit-sharing between the participants and the shareholders, which does not exist in the case of conventional insurance.

Earned Contribution: Earned contribution refers to the portion of a Takaful contribution that corresponds to the expired portion of the Takaful policy. In Takaful, contributions are typically paid in advance for a specific period of coverage. As time progresses and the policy is in force, the operator "earns" the contribution by providing coverage for that period.

Gharar: An Arabic term used in Islamic finance referring to uncertainty, hazard, or ambiguity in a contract.

Hibah: In Islamic finance, "hibah" refers to a unilateral gift given voluntarily by one party to another without any expectation of reciprocity. In the context of Takaful operations, hibah may be utilized to address deficits within the participants' funds, effectively transferring the ownership of assets without any consideration.

Hybrid (Wakala & Mudarabah) Model: Wakala represents a contract where one party acts as an agent to manage another party's funds or assets for an agreed fee or commission. Meanwhile, Mudaraba is a partnership arrangement where one party provides the capital and the other contributes expertise or labor (Mudarib), and profits are shared according to a pre-agreed ratio while bearing potential losses.

IFSB: Islamic Financial Services Board

Islamic Commodity Funds: A finance vehicle in the realm of Islamic finance that focuses on investing in commodities in accordance with Islamic principles.

Ijarah Fund: An Ijarah fund is a financial mechanism in Islamic finance that operates based on the principle of Ijarah, which is akin to a leasing or rental agreement.

Kafalah: Kafalah is a concept in Islamic finance that refers to a guarantee or suretyship. It involves a contract where a third party assumes responsibility or acts as a guarantor for the fulfillment of a contractual obligation or debt owed by another party.

Maysir: An Arabic term in Islamic finance and ethics that refers to the concept of gambling or speculation.

Mudarabah: Mudarabah is a partnership-based contract in Islamic finance where one party provides the capital and another party offers expertise or labor (known as Mudarib). In this arrangement, the investor provides the

funds, while the entrepreneur or manager (Mudarib) contributes skills, effort, or expertise to undertake a business venture or investment activity.

Murabaha: Murabaha is a transaction in Islamic finance that involves the sale of goods at a marked-up price. It's a type of contract where the seller expressly mentions the cost incurred and the profit margin added to determine the selling price. In essence, it's a cost-plus-profit arrangement which allows the buyer to defer payment through installments.

Mudarabah Model: It is a type of Takaful Model where Mudarib, the Takaful operator, and the participants have a profit-sharing agreement. Mudarib manages investments and claims payments, while the participants combine their cash into a Takaful fund.

Mutual Insurance: A mutual insurance company is a privately-held insurance company that is owned by its policyholders. Mutual insurers are established with the sole purpose of providing its members with insurance coverage.

Muamalat: Muamalat refers to the transactions, contracts, and dealings involving monetary or economic activities within Islamic jurisprudence.

Participants: In the context of Takaful, a participant refers to an individual or entity that joins a Takaful scheme.

Qard-e-Hasn: Qard-e-Hasn is an interest-free loan extended out of goodwill in Islamic finance. The term "Qard" refers to a loan, and "Hasn" signifies "good" or "beneficial." It's a form of loan where the lender provides funds to the borrower without expecting any interest or profit in return.

Riba: It is an Arabic term that refers to the prohibition of interest or usury in Islamic finance.

Retakaful: Retakaful represents a Shari'ah-compliant reinsurance framework, serving as the Islamic counterpart to conventional reinsurance practices. It operates similarly to conventional reinsurance, but aligns with Islamic finance guidelines.

Retakaful Window: A Retakaful window refers to a specialized division or unit within a conventional reinsurance company that offers Retakaful services alongside its primary reinsurance operations. This setup allows a conventional reinsurance company to provide Retakaful services to Islamic insurance companies (Takaful operators), while maintaining its traditional reinsurance activities.

Shari'ah: Shari'ah is the set of guidelines and rules that guide Muslims in how to live their lives. It covers everything from daily routines like prayer and charity to how people should behave and do business. It's like a moral compass for Muslims, guiding them to be fair, kind, and follow the teachings of Islam in all aspects of life.

Shari'ah Advisor: An expert in Islamic law and finance who provides guidance and oversight to ensure that financial products, services, and business practices comply with Shari'ah principles.

Shari'ah Supervisory Board (SSB): A Shari'ah Supervisory Board (SSB) is an independent body that is composed of high-standing religious scholars with in-depth knowledge of Islamic jurisprudence on the matters of financial transactions. It's established by Islamic financial institutions, such as banks or insurance companies, to ensure that their operations, products, and services comply with Shari'ah principles.

Sukuk: Sukuk, often referred to as Islamic bonds, are financial instruments structured to adhere to Islamic principles. Unlike conventional bonds that involve interest payments, sukuk represent ownership or a share of an underlying asset, project, or investment in compliance with Shari'ah law.

Tabbaru: A concept in Islamic finance that refers to voluntary contributions made by participants in a Takaful scheme.

Takaful: Takaful is an Islamic insurance system based on the principles of mutual cooperation, shared responsibility, and solidarity. It operates as an alternative to conventional insurance while adhering to Shari'ah guidelines.

Ta'awun: Ta'awun refers to the concept of mutual cooperation or assistance in Islam. It is one of the fundamentals of Takaful on which the whole framework has been established, thereby upholding the values of cooperation, solidarity, and social responsibility that are deep-rooted in the Islamic injunctions pertaining to financial matters.

Takaful Contribution: It refers to the amount paid by participants into the Takaful fund.

Takaful Operator: An entity that administers and manages a Takaful scheme. It can be an insurance company or a specialized institution specifically set up to operate Takaful arrangements.

Takaful Funds: Takaful funds are owned by Takaful participants, and they are managed to preserve their interest. The operator establishes policies and procedures for establishing Takaful funds, including the establishment of participants' risk or investment funds.

Ulema: Refers to scholars or learned individuals in Islamic knowledge and jurisprudence.

Wakala Fee: Wakala fee refers to the compensation payable to the Takaful operator in return for the services rendered by the Takaful operator in managing the risk funds on behalf of the participants.

Wakala Model: The Wakala Model refers to a specific arrangement where the Takaful operator, responsible for managing the Takaful fund, is appointed as an agent by the participants.

Zakat: Zakat is an obligatory charitable contribution in Islam. It's considered one of the five pillars of Islam and is mandatory for eligible Muslims who possess wealth above a certain threshold to give a portion of their wealth to those in need.

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