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The Principles of Conventional Insurance and Takaful Insurance.

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Introduction

Unforeseen events and emergencies can happen to anyone. It can lead to the loss of a loved ones or some prized possessions. Humans have always been planning for their future. In order to protect ourselves from such situation and assure that we will get some financial support, we buy insurance. There are two different types of insurance:

- Conventional Insurance
- Takaful Insurance

WHAT IS CONVENTIONAL INSURANCE

Insurance provides the means for people to transfer the burden of uncertainty of financial losses to the insurer, for an agreed financial consideration called the premium. In exchange, the insurer promises to provide financial compensation to the insured should a specified loss occur. It is a risk transfer mechanism by which individuals or organizations can exchange their uncertainty of financial losses or risks for the certainty of the premium. It is a fixed premium, the insured is certain that he will not have to pay more for that year. This service of providing certainty of cost fixed premiums is of immense value especially to organizations, as it would help them budget their expenditures. This is the financial security provided by modern insurance.

Insurance Is an arrangement in which a person makes regular payments to a company, and the company promises to pay money if the person is injured or died, or to pay money equal or less to the value of something such as a house or car if it is damaged, lost, or stolen.

Insurance is a means of protection from financial losses. It is a form of risk management primarily used to hedge against the risk of a contingent, uncertain loss.

An entity which provides insurance is known as an insurer, insurance company, or insurance carrier. A person or entity who buys insurance is known as an insured or policyholder. The insurance transaction involves the insured assuming a guaranteed and known relatively small loss in the form of payment to the insurer in exchange for the insurers promise to compensate the insured in the event of a covered loss. The loss may or may not be financial, but it must be reducible to financial terms, and must involve something in which the insured has an insurable interest established by ownership, possession, or pre-existing relationship. The insured receives a contract, called the insurance policy, which details the conditions and circumstances under which the insured will be financially compensated. The amount of money charged by the insurer to the insured for the coverage set forth in the insurance policy is called the premium. If the insured experiences a loss which is potentially covered by the insurance policy, the insured submits a claim to the insurer for processing by a claims adjuster.

Principles of Insurance

The important principle of insurance are as follows:

The main motive of insurance is cooperation. Insurance is defined as the equitable transfer of risk of loss from one entity to another, in exchange for a premium.

1. Nature of contract:

- Nature of contract is a fundamental principle of insurance contract. An insurance contract comes into existence when one party makes an offer or proposal of a contract and the other party accepts the proposal.
- A contract should be simple to be a valid contract. The person entering into a contract should enter with his free consent.

2. Principal of utmost good faith:

- Under this insurance contract both the parties should have faith over each other. As a client it is the duty of the insured to disclose all the facts to the insurance company. Any fraud or misrepresentation of facts can result into cancellation of the contract.

3. Principle of Insurable interest:

- Under this principle of insurance, the insured must have interest in the subject matter of the insurance. Absence of insurance makes the contract null and void. If there is no insurable interest, an insurance company will not issue a policy.
- An insurable interest must exist at the time of the purchase of the insurance. For example, a creditor has an insurable interest in the life of a debtor, A person is considered to have an unlimited interest in the life of their spouse etc.

4. Principle of indemnity:

Indemnity means security or compensation against loss or damage. The principle of indemnity is such principle of insurance stating that an insured may not be compensated by the insurance company in an amount exceeding the insured's economic loss.

In type of insurance the insured would be compensation with the amount equivalent to the actual loss and not the amount exceeding the loss.

This is a regulatory principal. This principle is observed more strictly in property insurance than in life insurance.

The purpose of this principle is to set back the insured to the same financial position that existed before the loss or damage occurred.

5. Principal of subrogation:

The principle of subrogation enables the insured to claim the amount from the third party responsible for the loss. It allows the insurer to pursue legal methods to recover the amount of loss, For example, if you get injured in a road accident, due to reckless driving of a third party, the insurance company will compensate your loss and will also sue the third party to recover the money paid as claim.

6. Double insurance:

Double insurance denotes insurance of same subject matter with two different companies or with the same company under two different policies. Insurance is possible in case of indemnity contract like fire, marine and property insurance.

Double insurance policy is adopted where the financial position of the insurer is doubtful. The insured cannot recover more than the actual loss and cannot claim the whole amount from both the insurers.

7. Principle of proximate cause:

Proximate cause literally means the ‘nearest cause’ or ‘direct cause’. This principle is applicable when the loss is the result of two or more causes. The proximate cause means; the most dominant and most effective cause of loss is considered. This principle is applicable when there are series of causes of damage or loss.

Historical Background of Sharia Insurance (Takaful)

Since 622 AD the concept of has been practiced in different forms. The foundation of the mutual insurance was laid with the help of sharing the responsibilities between the Muslims. In 1976 a Fatwa was issued by the Higher Islamic Council of Saudi Arabia that Takaful is legitimate as compared to the conventional insurance.

Since then considering the Islamic values the rules and regulation for the Takaful have been formulated. Based on this concept in 2008 the Islamic industry grew from $1.338 billion to $5.318 billion. There are more than 133 companies that are working on these rules. The leading countries are the Gulf States, and Malaysia.

THE ISLAMIC INSURANCE (Takaful)

It is a type of insurance system in Islam that is based on the laws of Sharia or Islamic principles. It is a system in which money is pooled and invested. It is a mutual risk transfer arrangement in which both parties will share the profit and loss equally.

Takaful is the Islamic alternative to conventional insurance which is based on the idea of social solidarity, cooperation and joint indemnification of losses of the members. It is an agreement among a group of persons who agree to jointly indemnify the loss or damage that may indicts upon any of them out of the fund they donate collectively.

The concept of takaful literally referred to as social solidarity and practically referred to as Islamic insurance is not widely understood. Takaful is an important part of the Islamic Financial system, the concept itself and the nature of the operations of takaful companies is a topic that has been relatively neglected compared to Islamic banking. Takaful is a plan based on solidarity and brotherhood, which provides mutual financial aid and assistance to its Contributors in case of need, whereby the Contributors mutually agree to contribute for that purpose.

“Takaful plan” it is a word of an Arabic origin which means a system of Islamic insurance based on the principle of “Taawun” (mutual assistance) and “Tabarru” (voluntary contribution). Takaful technically means joint guarantee, whereby a group of Contributors agree to mutually guarantee each other against addended loss, which suggests that the Contributors are both insurers and insured in the arrangement.

Similarities and differences between takaful and conventional insurance:

- Takaful is a cooperative institution based on the principles of contract for mutual cooperation “taawun”. While conventional is a business institutions operated based on the principles of contract.
- In takaful which is based on the principle of mutuality member are insured and insurers themselves. All the losses are shared by the members themselves and as such to transfer of risk is involved while the basic service operated by the conventional insurance to the community is the transfer of the indeterminate fortuitous economic losses associated with the stipulated risks in return for a pre-determined payment known as premium. Thus it has been said and recognized that through the mechanism of conventional insurance, the insured substitutes certainly for uncertainly.
- Takaful Insurance is dealing with Halal products only.

- In takaful shareholder of the company, if any, are not entitled to participate in the profits generated by the insurance operators, while In the case of conventional insurance the primary motivation is to earn profit from the insurance transactions for the shareholders.
- Takaful, the Islamic alternative to conventional insurance is based on the idea of social solidarity, cooperation and joint indemnification of losses of the members.
- In conventional insurance the contract is based on the principles of exchange of interest. The relationship is designed in such a way that the insured buys protection by payment of premium, and insurer provides protection against the insured risk. Under Islamic law insurance transaction cannot be concluded on this basis of buy and sale contract.
- The conventional insurance is a contract between two parties whereas takaful is a relationship in which everything is shared.
- In conventional insurance, everything is planned according to the profit that each party will earn, however, earning profits is not the major purpose of takaful concept.
- In takaful, both parties will equally divide the burden whereas in conventional insurance one party will take the risks for other.
- Takaful is based on the sharia in Islam whereas conventional insurance follows the rules formulated consider profit in mind.

Samples of Takaful Insurance Principles

- **First principle: contribution as a basis of Takaful Insurance**

Takaful Insurance is a contribution contract between a group of persons to cooperate together in order to fragmentize the risks stated in the contract and taking part in compensating the actual damages that incur to the subscribers, resulting from the occurrence of the risk insured against.

- **Second principle: The Contributor as interest holder in Takaful**

The CONTRIBUTORS means the group of persons (natural or artificial) subject to a certain risk or certain risks mentioned in the contract, try to avoid the effects of the risks and compensate the damages that one of the contributors may be subject to through compensating the actual damage resulting from the occurrence of such risks. This is done by the commitment of each of them to contribute the payment of a certain amount decided by the insurance policy (subscription/ installment).

- **Third principle: Managing the insurance processes and investing its funds on behalf of a group or the subscribing body**

  There are two cases:

1. **First case:** there is no legal system that prevents or bans the subscribing body from managing the insurance processes and investing its funds. This is the original rule and the correct one, but it is not realized owing to practical and legal considerations.
2. **Second case:** there is a legal system that allows the subscribing body to manage the insurance processes. Here, the legal actuality imposes the idea that stock companies will manage Takaful Insurance process on the basis of management contract and an investment between the stock company and the subscribing body. In other words, this is done pursuant to a contract under which the stock company manages and invests the insurance portfolio for the interest of “the subscribers”; this is as per the rules and controls of Islamic Shariah.

- **Fourth principle: Profit is a consequence and not a target in Takaful Insurance Contract**

  This means that Takaful Insurance policy is based on cooperation and Takaful depend on the contribution contract. Hence, the owner of the policy does not wait for a profit from it. Therefore, the net profit may be reflected in the form of decreasing the value of contributions after deducting the expenses and constituting the reserves, because the development of funds belongs to the owner.

- **Fifth principle: Contribution to the total of contributors as artificial group or as independent artificial person**

  The total of the insurance funds acquire the independent artificial quality by mixing these funds and disposing of them as per what the common jurists decide (Al-Hanafi, Al-Maliki, and Al-Shafeai)

- **Sixth principle: Takaful Insurance Surplus System (6)**
- It is necessary that the conditions of Takaful Insurance policies should be identical with the rules of Islamic Shariah
- It is also necessary to revise the Traditional Commercial Insurance policies and remove every condition that contradicts the rules of Islamic Shariah so as to make use of such insurance policies.
- It is necessary to state the principles of Takaful Insurance in the insurance policy.
- There are 4 different types of Takaful Insurance:

1. Modaraba Model.
2. Wakala Model.
3. Modaraba and Wakala Model.
4. Waqf Model.

Modaraba Model

In Modaraba, the Takaful Corporation acts as Modareb and Takaful shareholders as money owners. The Corporation as a Modaraba, manages the risks of both investment and insurance activities on behalf of the Takaful participants. In return, it receives a share in the form of a percentage of the profits of the investment and / or surplus Takaful, which is usually mentioned explicitly in the Takaful insurance contract.

Neither the Takaful Insurance Corporation nor the participants can change the agreed participation rate without returning to the other party in respect of the profits of the investment and / or the surplus Takaful after the signing of the contract. The Takaful Shareholders alone shall bear any financial losses on investment and insurance activities as owners, provided that the losses are not the result of misconduct or negligence by the Takaful Insurance Corporation. In this regard, Takaful expects to earn profits if it is only confirmed that the costs of managing the takaful insurance process are less than its aggregate share of investment profits and / or takaful surplus.

Definitions

1. Contributor's Investment Fund:

A fund in which part of the contributions paid by the contributors in Takaful are allocated for investment and / or savings.

2. Contributor's Risks Fund:

A fund in which part of the contributions paid by the contributors in Takaful are allocated to meet the claims of the contributors on the basis of cooperation or assistance.

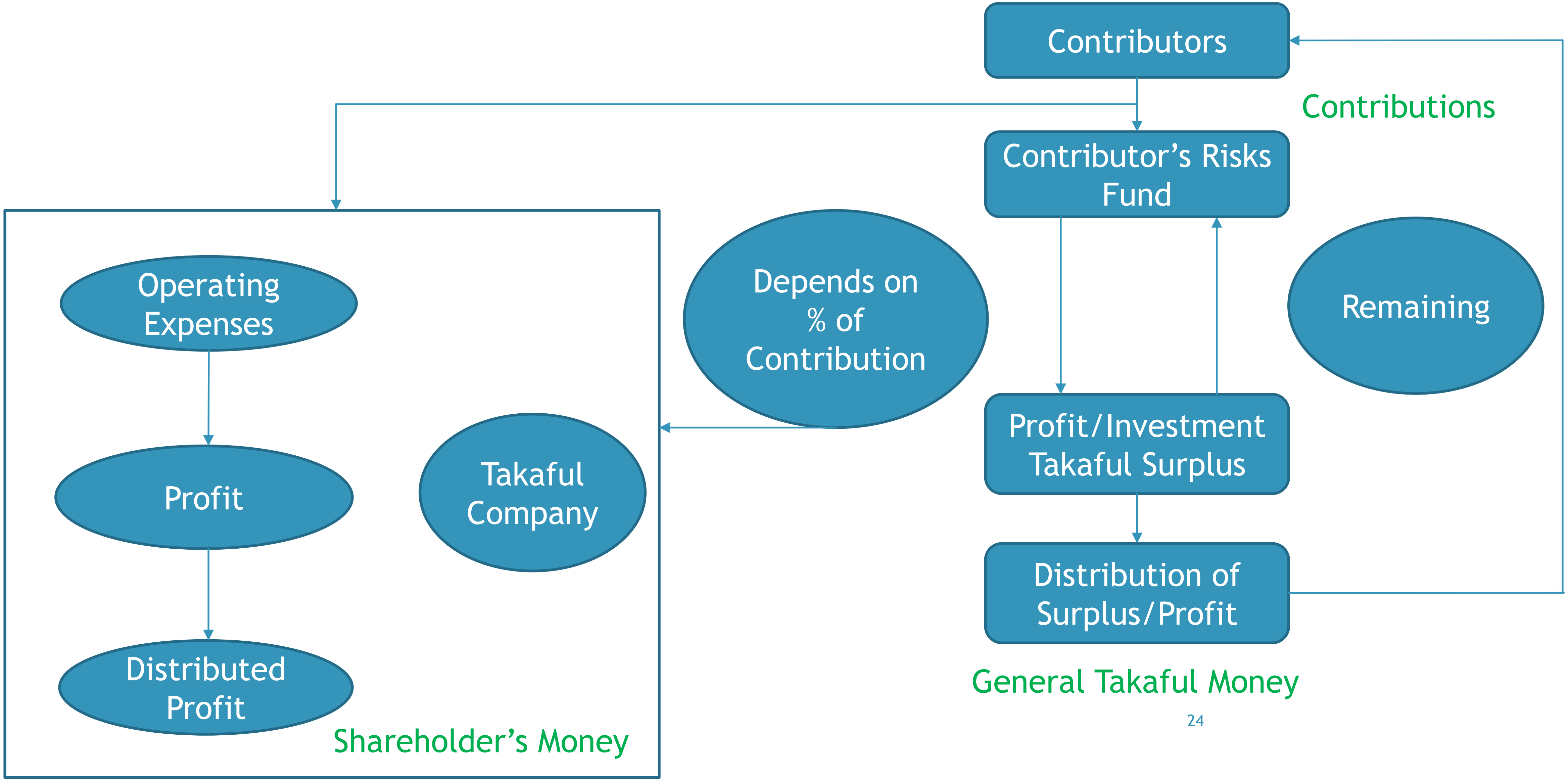
3. reserves:

Differed amounts in the financial position to cover claims arising from takaful contracts.

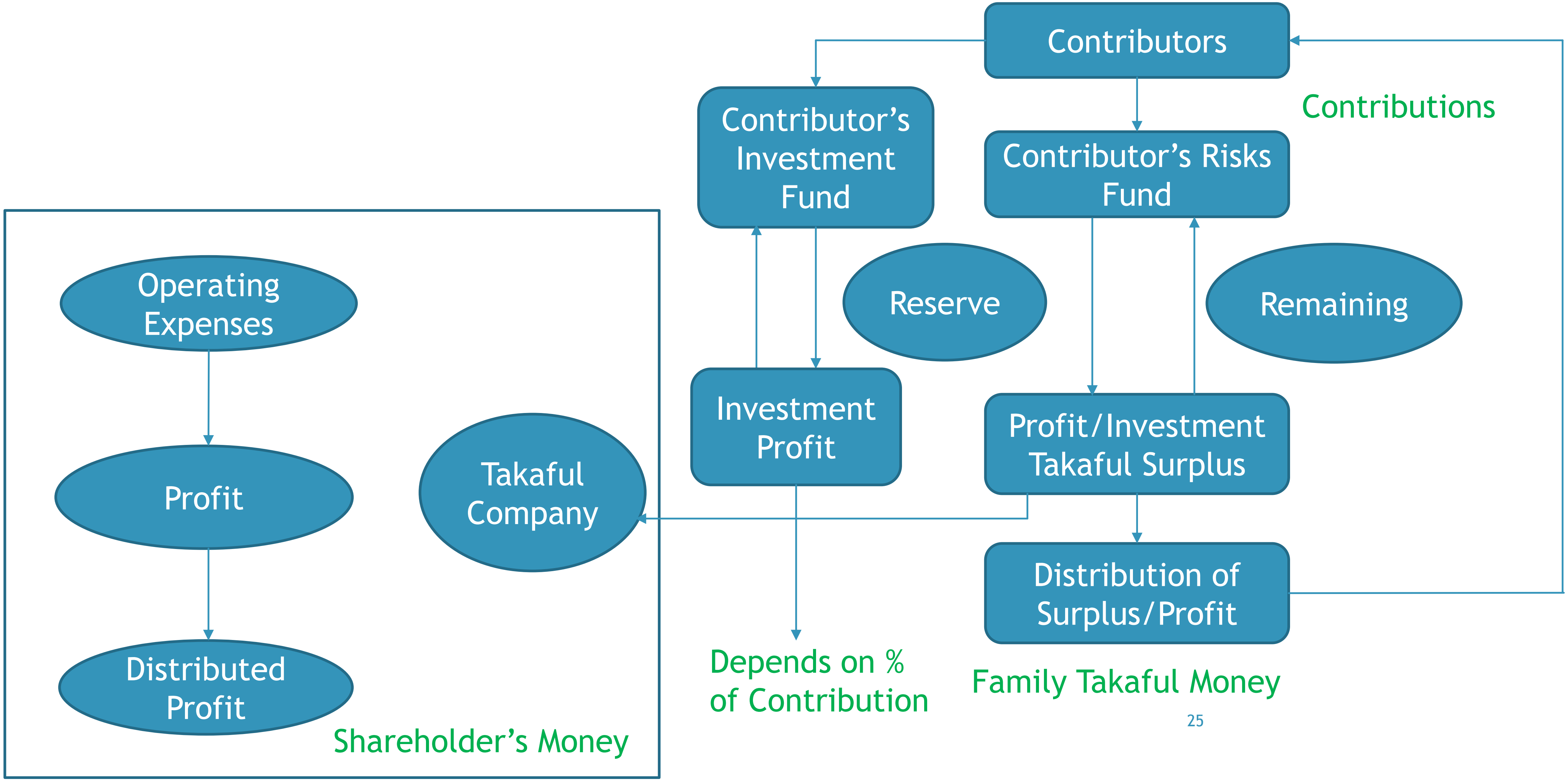
4. Surplus or losses:

The financial performance of the takaful fund, which is the balance after deduction of the expenses and claims from the contribution income and the addition of investment returns.

Takaful Contract - Modaraba Model - General Takaful:



Takaful Contract - Modaraba Model - Family Takaful:



Wakala Model

According to this model, the Takaful Insurance company is the agency and the contributors are the clients, the Takaful Company will be acting as an agent on behalf of the contributors, and acts in both the investment and takaful activities. , They receive administrative fees called wakala fees, which are usually a proportion of the paid contributions.

The fees of Wakala shall be agreed in advance and expressly stated in the Takaful Contract.

On the part of the Takaful Insurance Corporation, Wakala fees are expected to incur the total amount of:
(A) management costs, (b) distribution costs including brokerage remuneration, and (c) operating profit margin for the Takaful Insurance Corporation.

On this basis, the Takaful Insurance Organization will make profits if the Wakala fees charged are higher than the management costs it bears.

Nor do they directly participate in the risks faced by takaful insurance funds or any of their surpluses / deficits.

In addition, the Wakala model allows for an additional incentive to be received by the Takaful Insurance Corporation for good performance. In accordance with the agreed Takaful Agreement, performance fees are normally associated with Takaful result. With adequate reserves in the capital account for solvency support, there is no need from the perspective of the contributors for any excess of the insurance process. The level of contributions must be allowed, in addition to other requirements, to deduct reasonable wakala fees, including any incentive for good performance.

Takaful Contract - Wakala Model - General Takaful:

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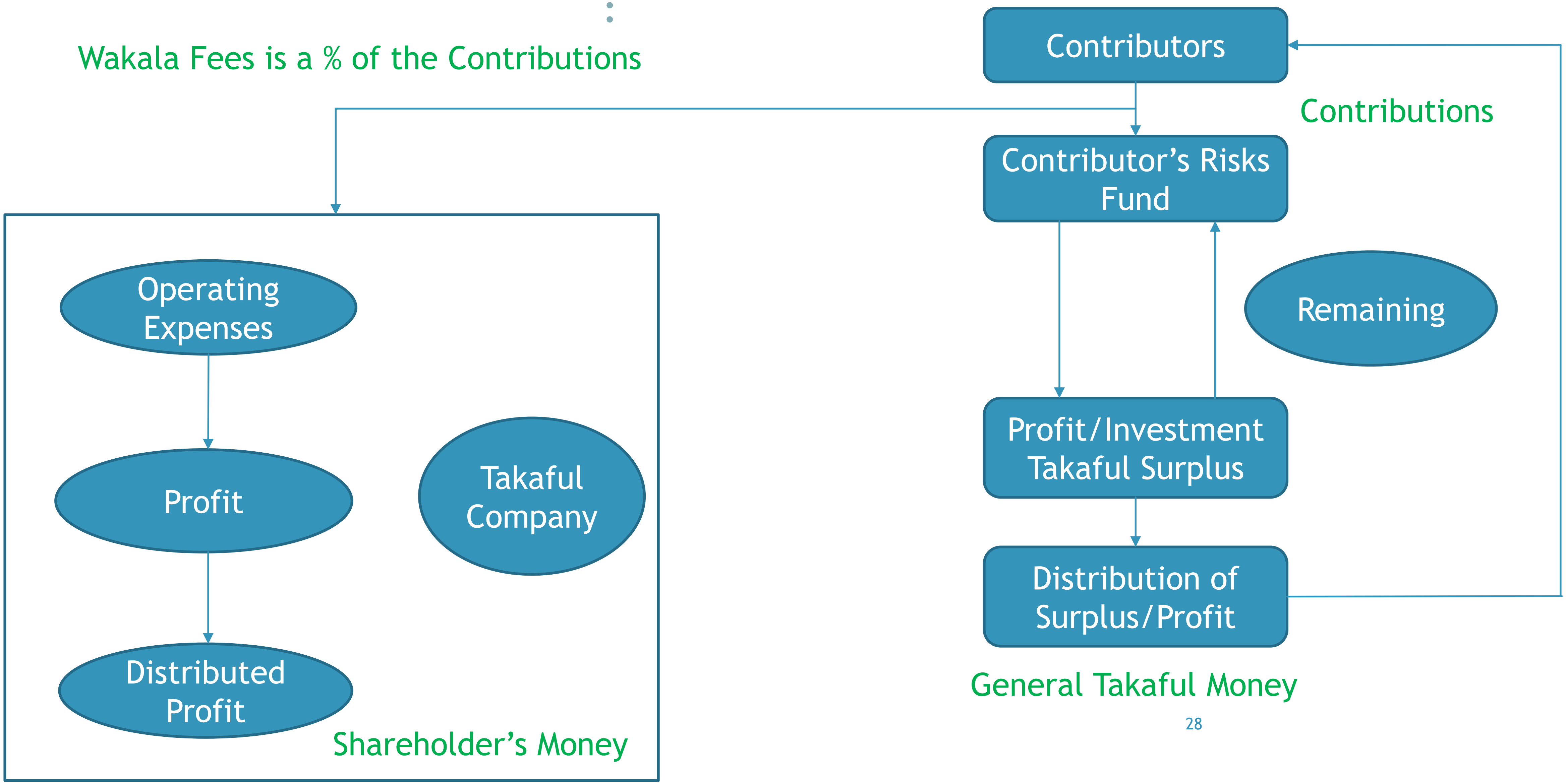
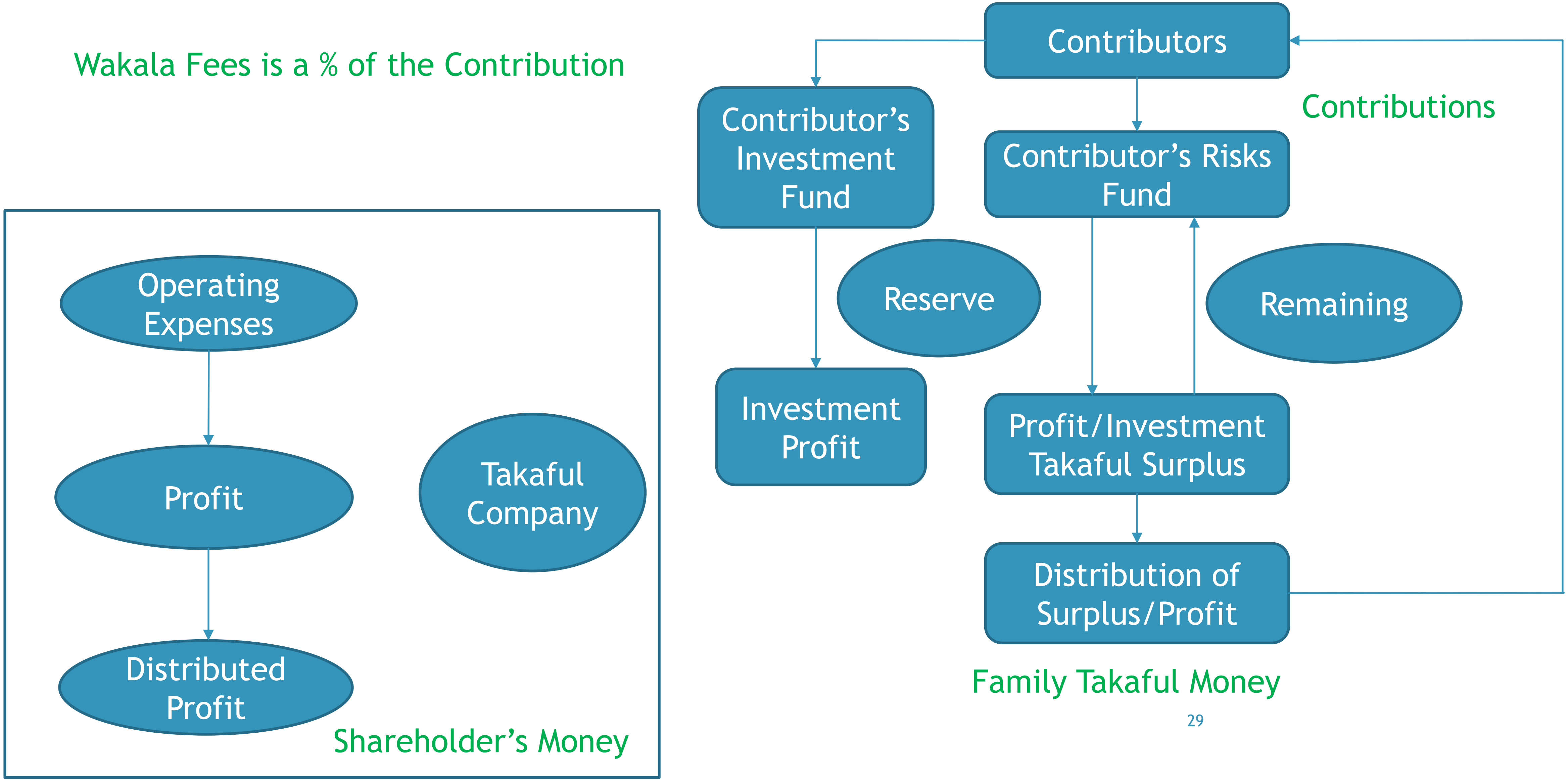


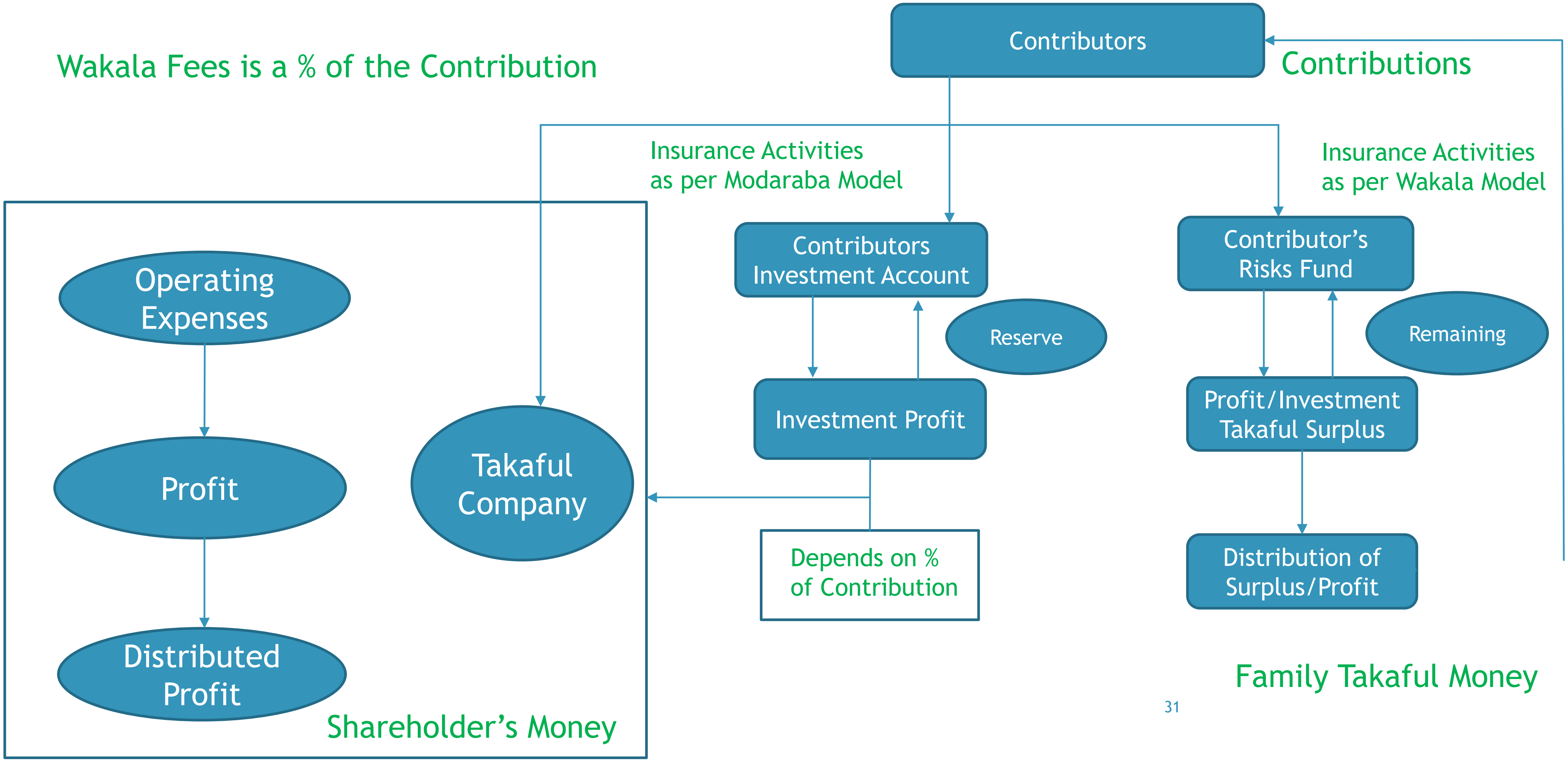
Takaful Contract - Wakala Model - Family Takaful



Modaraba and Wakala Model

According to this agreement, the Wakala contract is approved for Takaful insurance activities, while the Modaraba contract is used for investment activities. This seems to be a growing demand from Takaful insurance institutions.

Takaful Contract - Modaraba & Wakala - Family Takaful:



Comparison

Modaraba Model	Wakala Model
- Is based on a Profit sharing mechanism.	- Is based on an wakala contract.
- A business contract between the participants Who provide the fund or capital and operator That manages the business.	- A wakala contract is agreed between the participants and operator to conduct the business.
- Operator acts as a manager or "Modarib".	- Operator acts as an agent or "Wakil".
- A profit sharing ratio is decided between the participants and operator.	- Operator charges a fee under the agreement for the services its renders.
- Profit in takaful includes returns on investments And surplus from underwriting from participants Fund only. It does not include profit posted by the Operator itself.	- Operator earns its revenue from the wakala fee as well as returns on the investment of its shareholder's fund.

Sharia Governance

The takaful contract defines a unique relationship between the takaful operators and contributors. It requires takaful operators to duly observe fundamental obligations toward contributors, particularly in terms of adhering to Shariah principles, undertaking fiduciary duties and meeting prudential standards. In order to ensure compliance with Shariah rules and principles, it is necessary to develop a Sharia Governance system in takaful operation.

Shariah Governance system refers to the set of institutional and organizational arrangements through which a takaful operator needs to ensure that there is effective independent oversight of Sharia compliance. A key characteristic of independence is the ability to exercise sound judgment and views without any influence from any quarter. While carrying of his/her duties a member of the Shariah Council/Board should always have complete moral, intellectual and professional independence.

Islamic Financial Services Board (IFSB) has prescribed certain guiding principles on Shariah Governance system for institutions offering Islamic financial services. A takaful operator can follow these guiding principles to ensure Sharia compliance. These principles are as follows:

- a) The concerned Shariah council must have clear terms of reference regarding its mandate and responsibility. There can be a sound code of ethics and conduct that would enhance the integrity, professionalism and credibility of the members of the Shariah council.
- b) The takaful operator shall ensure that any person mandated with overseeing the Sharia governance system (SGS) fulfills acceptable fit and pooper criteria.
- c) The takaful operator shall facilitate continuous professional development of persons serving on its Shariah council as well as its internal Shariah Compliance & Audit department.

- d) There should be a formal assessment of the effectiveness of the Shariah council as a whole and of the contribution by each member to the effectiveness of the Shariah council.
- e) The Shariah council should play a strong and independent oversight role, to excise objective judgment on Shariah related matters. No individual or group of individuals shall be allowed to dominate the Sharia council’s decision making process
- f) In order to fulfill its responsibilities the Sharia council should be provided with complete, adequate and timely information prior to all meetings and on an ongoing basis.
- g) Shariah council members should ensure that internal information obtained in the course of their duties is kept confidential
- h) The takaful operator should fully understand the legal and regulatory framework for issuance of Shariah pronouncements/resolutions. It should also ensure that the Shariah council strictly observes the said framework and, wherever possible, promotes convergence of the Shariah governance standards.

Shariah pronouncements/resolutions refers to a juristic opinion on any matter pertaining to Shariah issues in Islamic insurance/takaful given by the appropriately mandated Sharia council. A Shariah pronouncement/resolution shall be issued only through appropriate due process. In jurisdictions where there is a central authority such as National Shariah Board/Council or Fatwa council, the central authority should have power to issue such pronouncements and the respective Shariah councils of the operators should ensure its compliance.

Each takaful operator should have Shariah compliance review/audit department for verifying that Shariah compliance has been satisfied. Any non -compliance should be recorded and reported and as far as possible be addressed and rectified. The internal Shariah compliance and audit department shall recommend to management to rectify and address the issues and report to Shariah council.

The burden of ensuring a sound and effective Shariah Governance system should not be left to members of the Shariah council only. Every stakeholder in takaful business, the customers, employees, agents, brokers, management, shareholders and the regulatory authority should also play a part in sharing the responsibility. However, the primary duties of Shariah council are as follows:

- a) Advise the Board of directors on Shariah related matters.
- b) Preview and endorse Shariah related policies and guidelines
- c) Prepare a Shariah process manual.
- d) Endorse and validate relevant documentation for new products and services, including contracts, agreements etc.
- e) Observe the computation and distribution of Zakat or any welfare fund channeled to charity.

- f) Delegate some of its functions to any or group of council members, management team or outside experts.
- g) Endorse and validate product guidelines, investment guidelines, marketing, advertising and sales literatures, illustrations etc.
- h) Submit reports regularly to Board of directors in relation to Shariah Audit findings, product design, balance sheet, financial statements
- i) Submit annual Shariah compliance report for onward disclosure & distribution to shareholders, policy holders.
- j) The secretary of the Shariah council shall be responsible for recording the minutes of meetings. All minutes be properly archived by the secretary for future reference.

- k) Relevant minutes of the Sharia council meeting be submitted to relevant departments and senior members of management.
- l) Ensure that the council is transparent and its independent character is not jeopardized
- m) Promote appropriate ethics and values within the organization and ensure continuous improvement of Shariah control process
- n) Each member of Shariah council should contribute to the best of his/her ability in enriching the discussion and deliberation of the issues raised in the Shariah council's meetings.
- o) Each member of Shariah council should strive for continuous self- improvement, demonstrate integrity and accept responsibility with due care and diligence.
- p) Each member of the Shariah council should exercise rational and logical reasoning, demonstrate willingness to learn from others and strive to be in achieving qualities.

Shariah members should posses competencies in respect of academic qualification and or reasonable experience in Islamic finance, Islamic commercial law (Fiqh Al Muamalat) and be able to demonstrate an adequate understanding of Shariah based financial transactions. Shariah members are also expected to have strong skills in the philosophy of Islamic law (Usul-al-fiqh) and be very conversant with the primary sources of the Shariah. It is also expected that the members of the Shariah council should have good knowledge of Arabic and be able to converse in English. Furthermore, a member be able to display and understanding of the following:

(1) Shariah rules relating to Takaful operation

(2) General Legal and Regulatory Framework that may apply in Takaful transactions

(3) Impact of introducing Takaful schemes to the market in achieving the object of Shariah (Maqasid Al-Shariah)

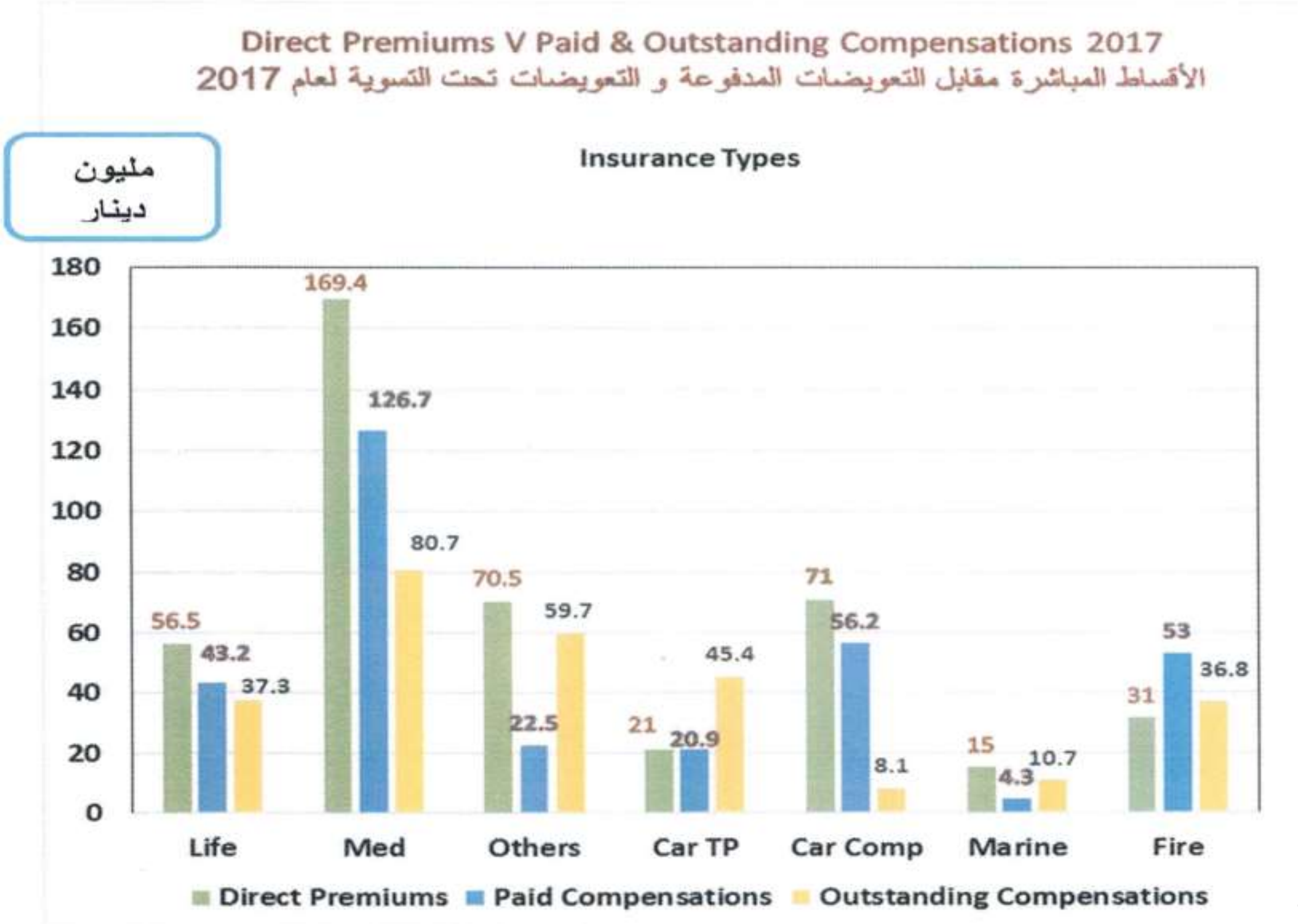
Facts about the Kuwaiti Insurance Market

- The Insurance has started in Kuwait since more than 50 years, when Kuwait Insurance Company “the first National and Conventional Insurance Company in the Kuwaiti Market and GCC” was established on 10^{th} August 1960.
- Today, we have more than 35 Conventional and Takaful Insurance Companies in Kuwait.
- On 2001, we have welcomed the First Takaful Insurance Company as the First National and Takaful Insurance Company in Kuwait.
- On 1972, the Kuwait Reinsurance Company was established to provide the Reinsurance services in Kuwait and overseas.

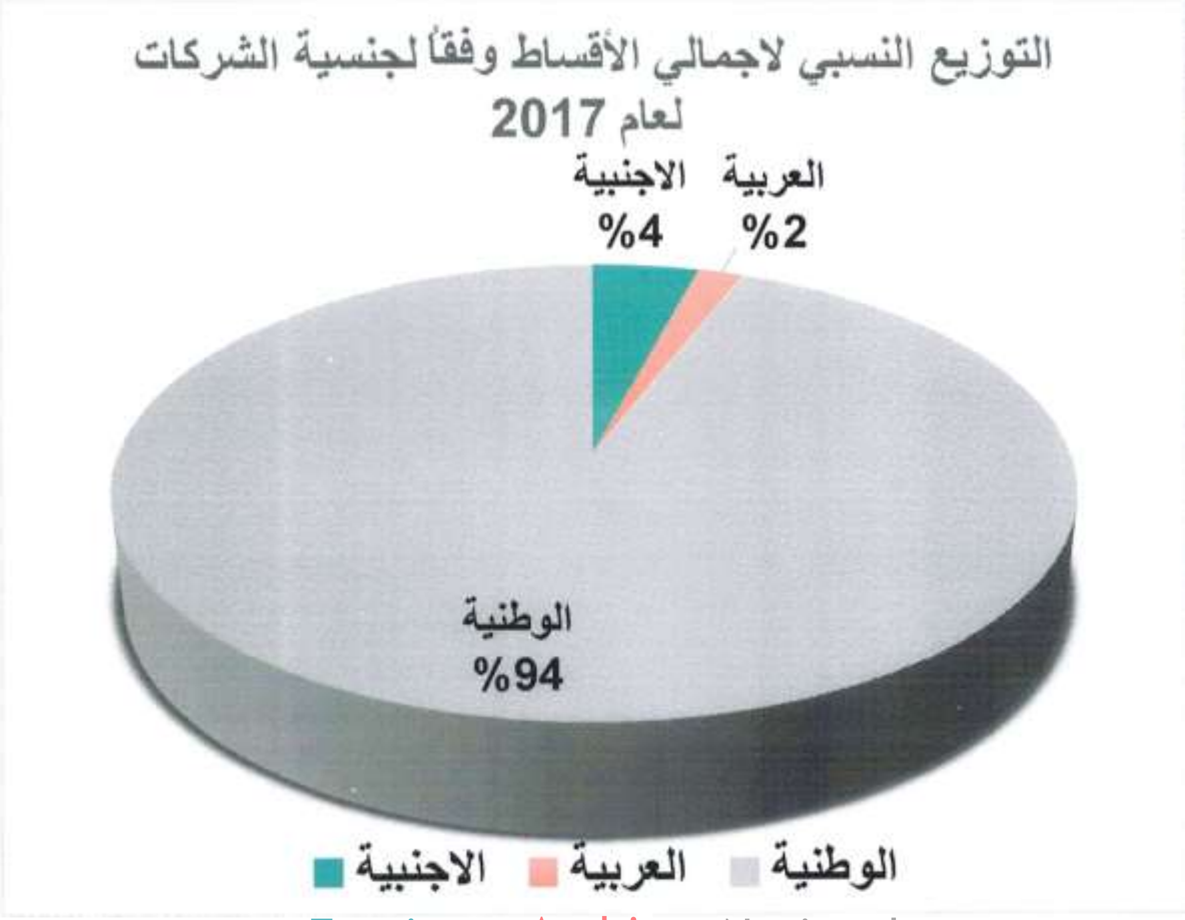
- On 26th June 2006, The Kuwait Insurance Federation was established to achieve the following:

1. Organizing courses to increase the Insurance Knowledge for the members.
2. Held Conferences.
3. Publishing Magazines, Books, Specialist Studies etc.
4. Form Committees in all lines of business.

However, KIF is not consider as a Regulator as it doesn’t has a control on the members in respect of their Insurance Policies and/or rates etc.

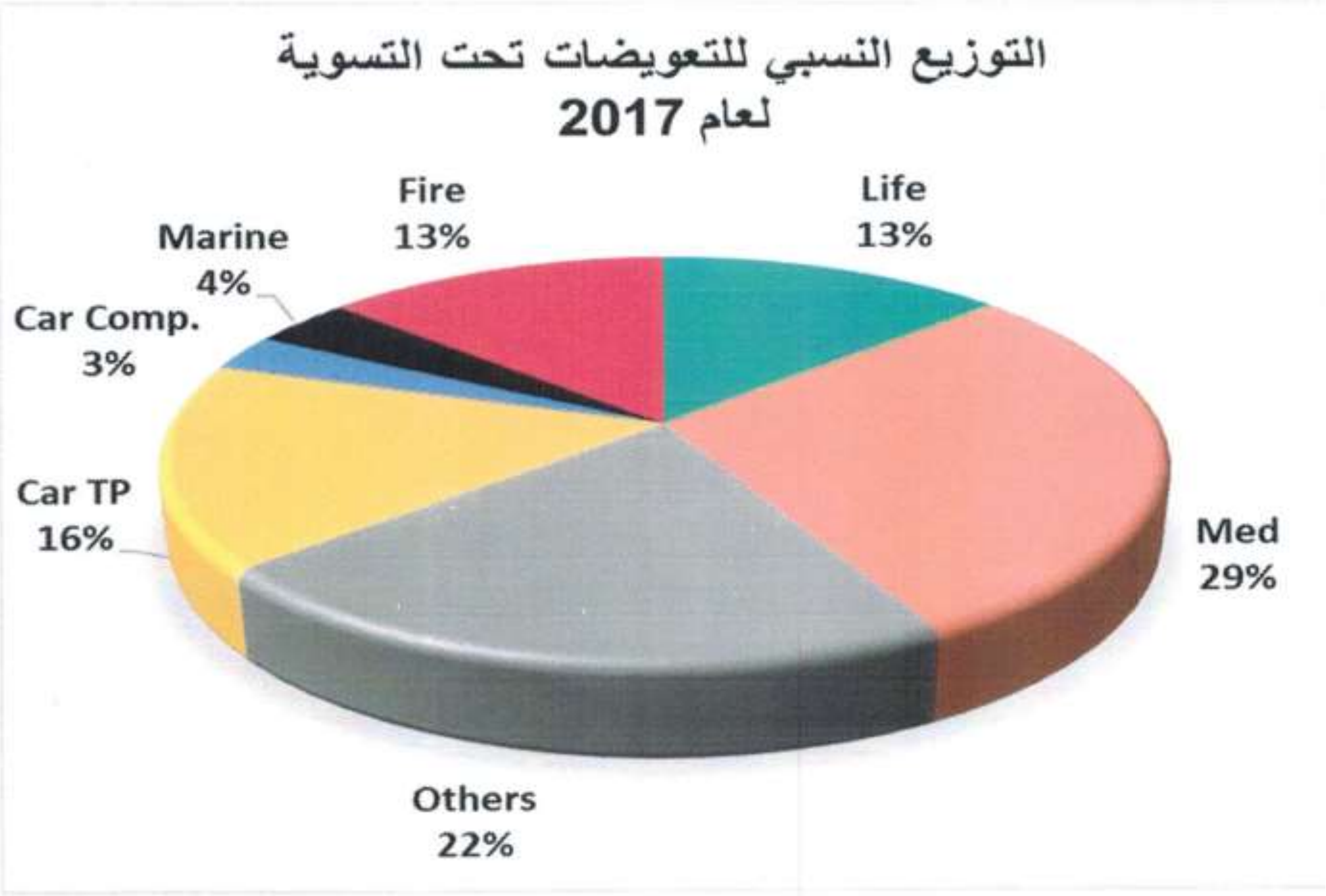

Direct Premiums V Paid & Outstanding Compensations 2017
الأقساط المباشرة مقابل التعويضات المدفوعة و التعويضات تحت التسوية لعام 2017
مليون
دينار
Insurance Types
180
160
140
120
100
80
60
40
20
0
56.5
43.2
37.3
169.4
126.7
80.7
70.5
22.5
59.7
21
20.9
45.4
71
56.2
8.1
15
4.3
10.7
31
53
36.8
Life
Med
Others
Car TP
Car Comp
Marine
Fire
Direct Premiums
Paid Compensations
Outstanding Compensations

Total Premiums as per Companies Nationalities for 2017:

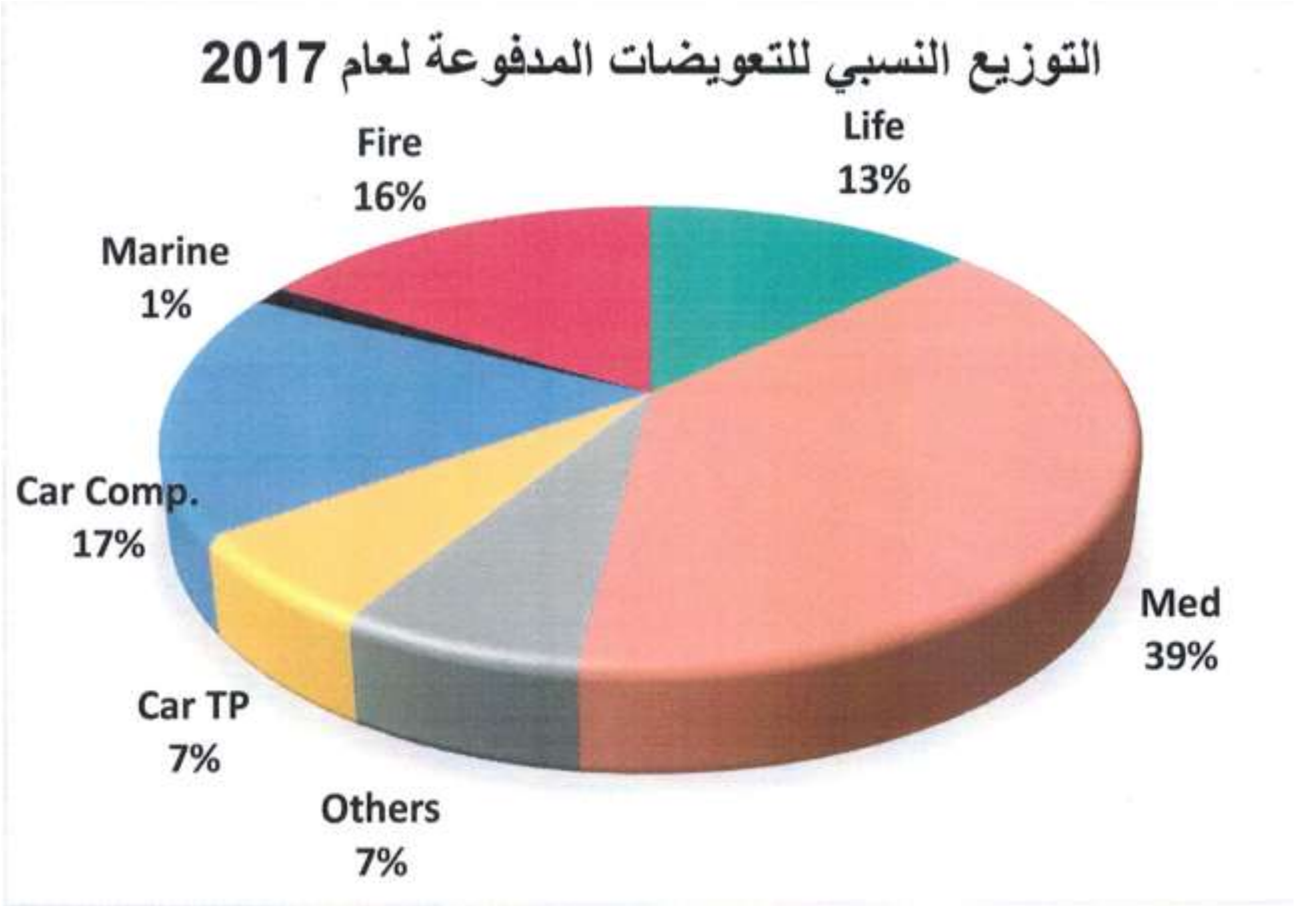


Foreign Arabic National

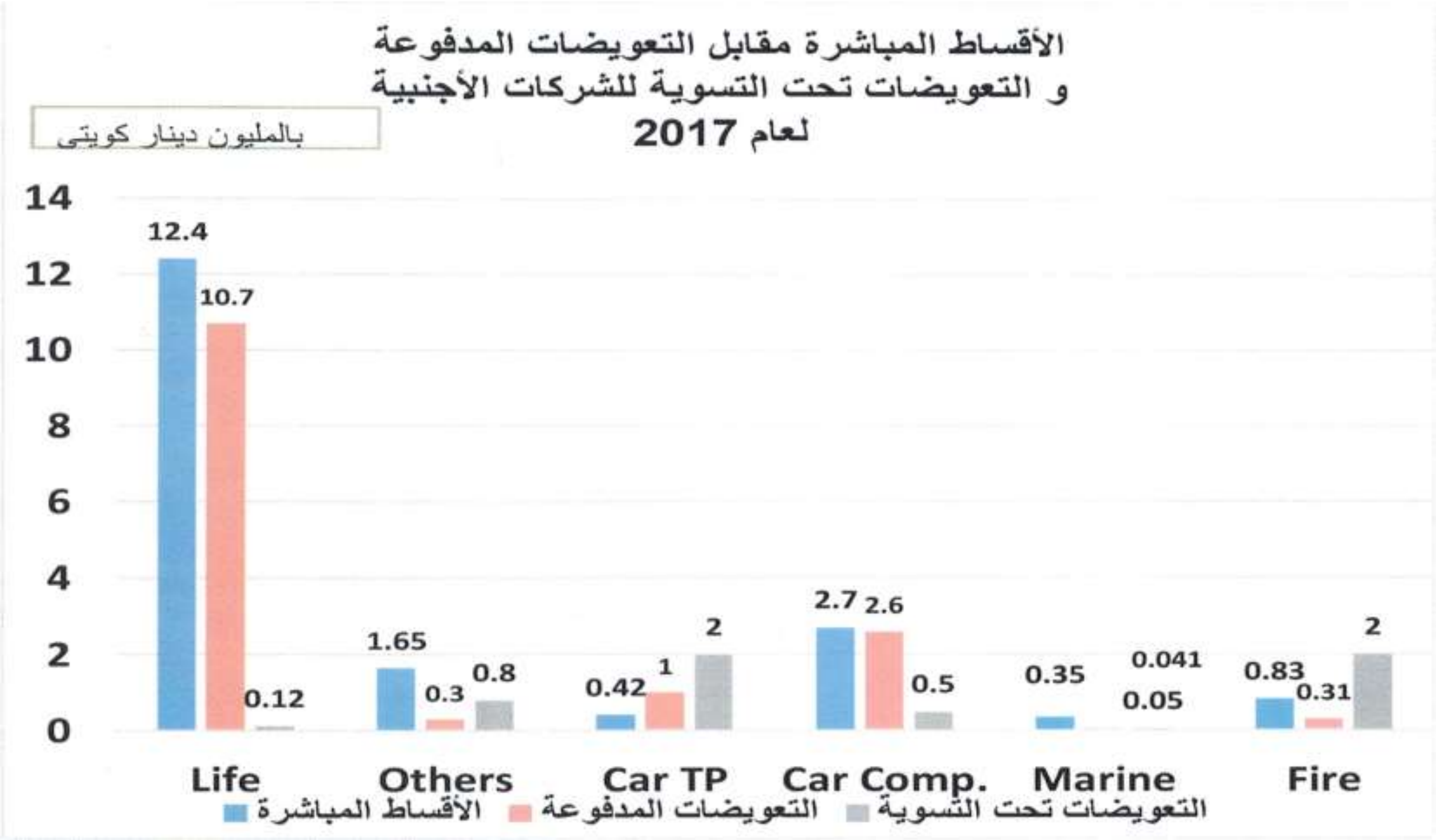
Outstanding Claims of 2017:



Paid Claims of 2017:

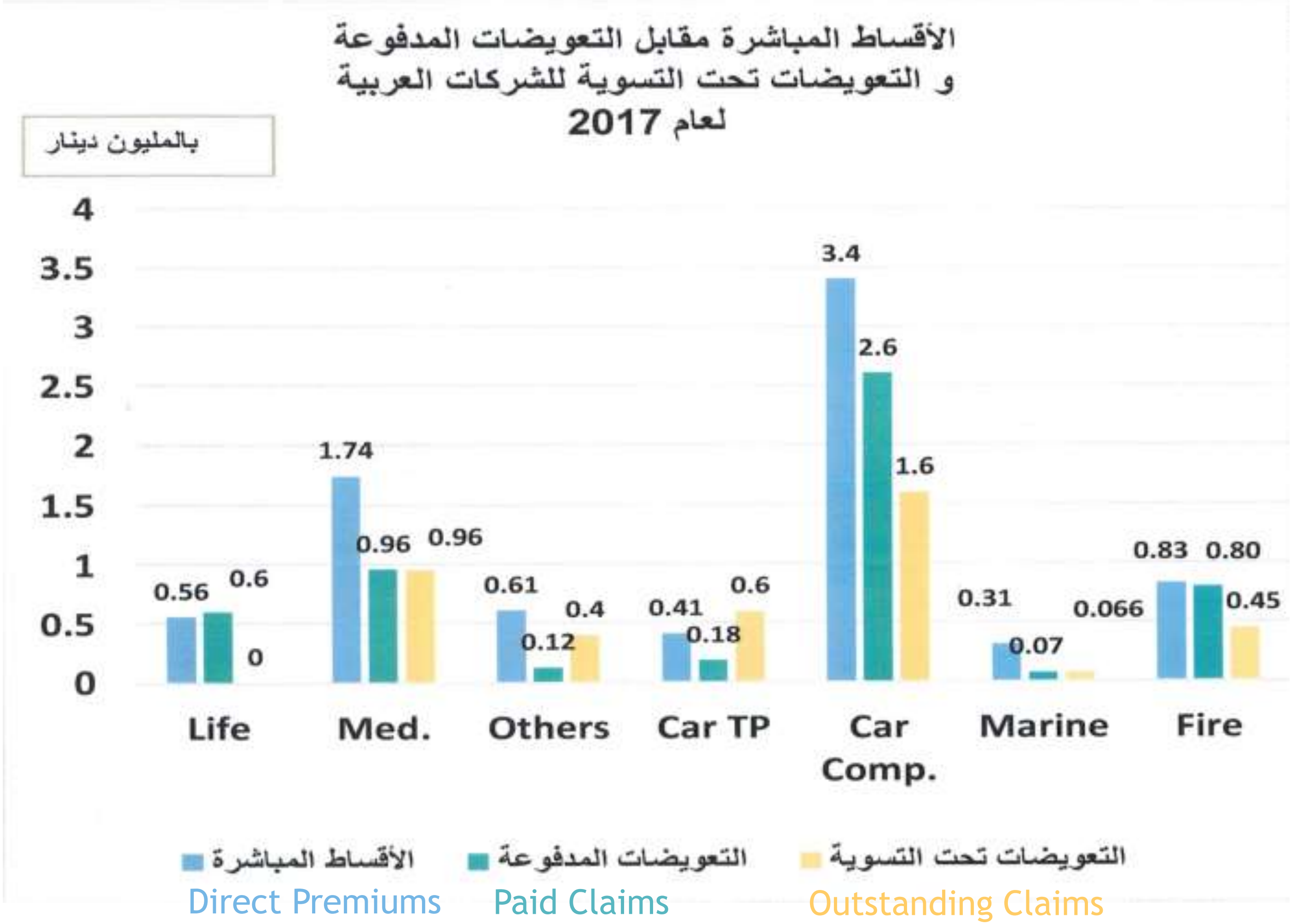


Direct Premiums vs Outstanding and Paid Claims, Foreign Companies – 2017:



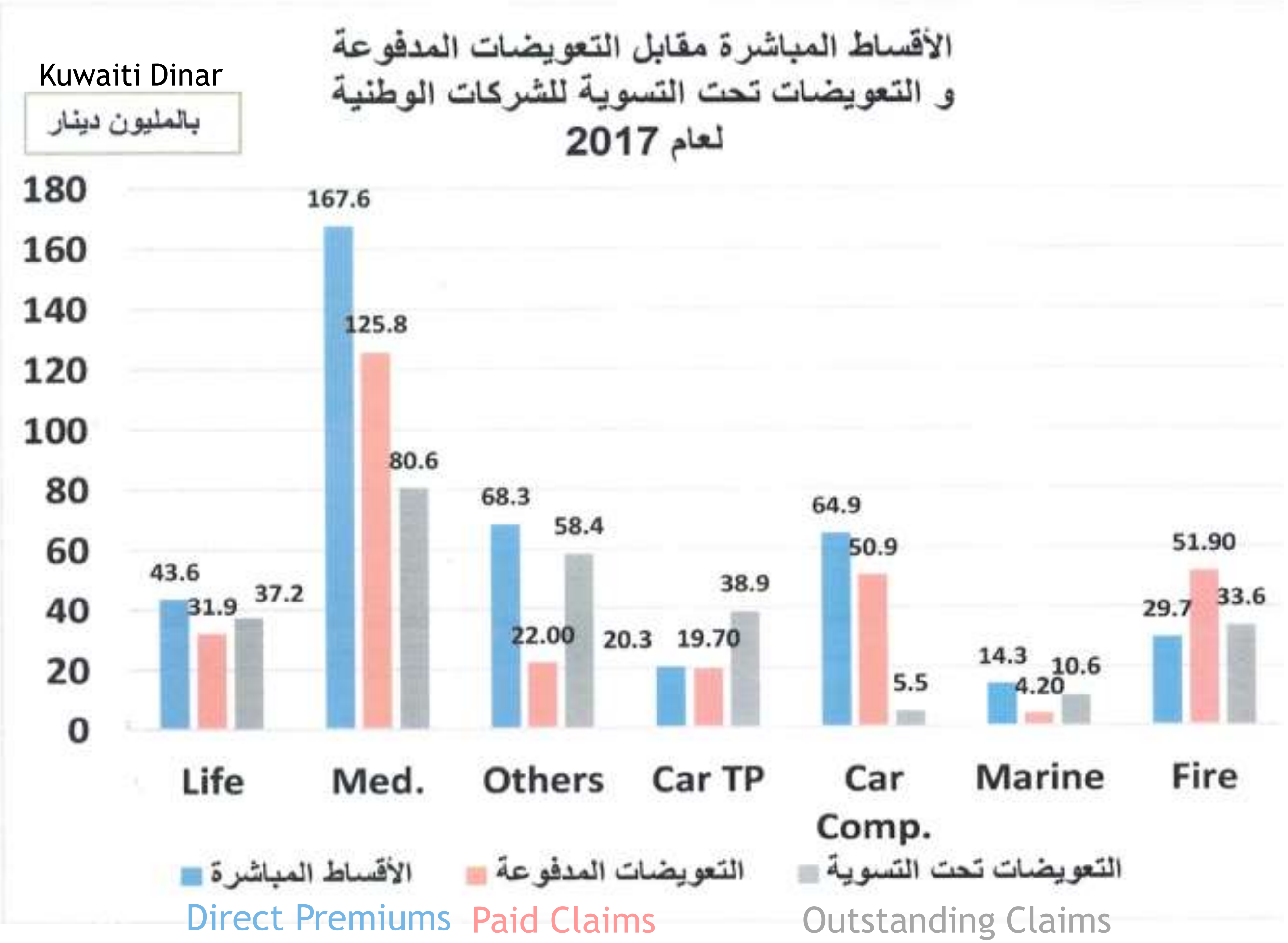
Direct Premiums Paid Claims Outstanding Claims

Premiums vs Paid and Outstanding Claims, Arab Companies – 2017:

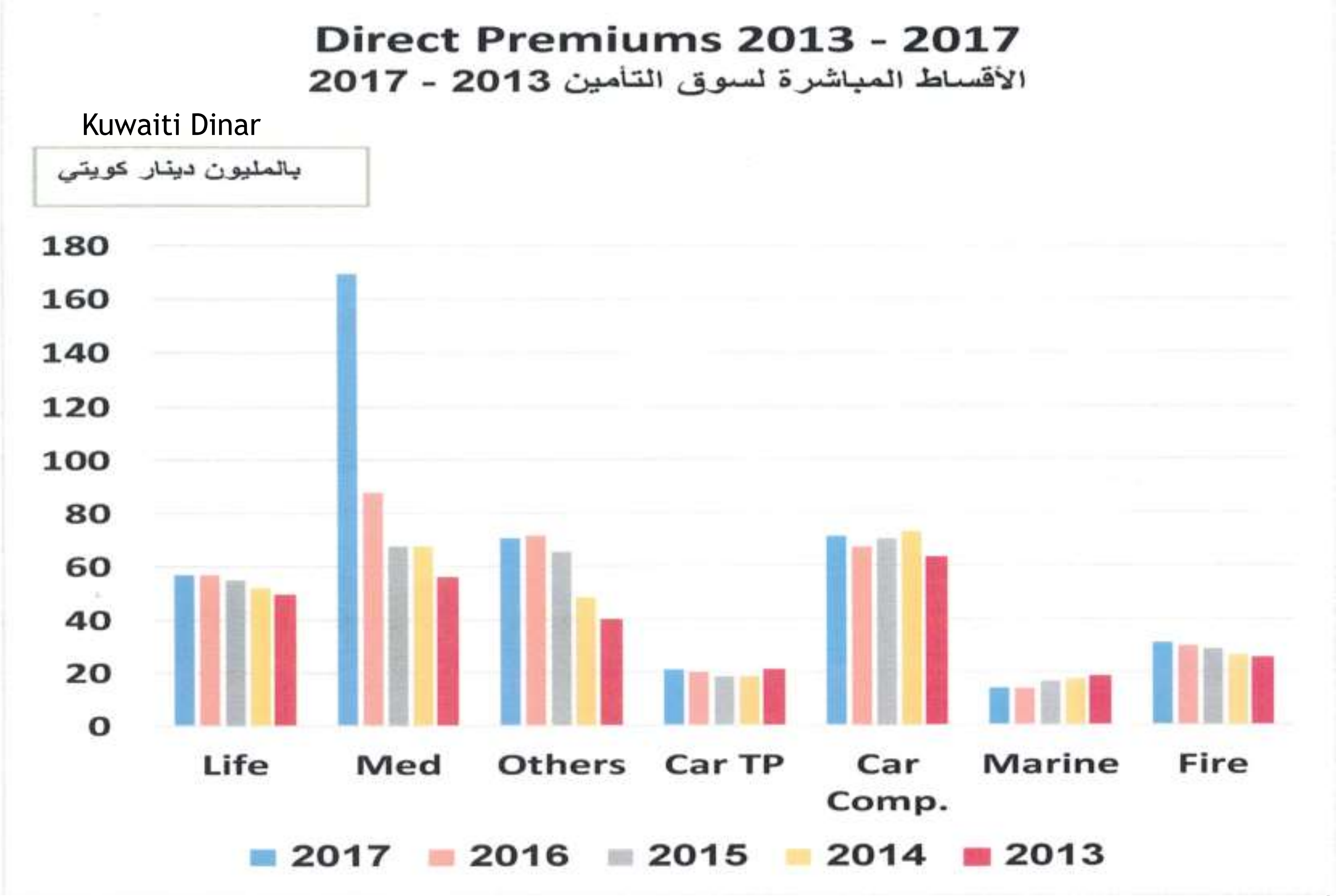


Motor TPL vs Comprehensive Insurance for 2017:

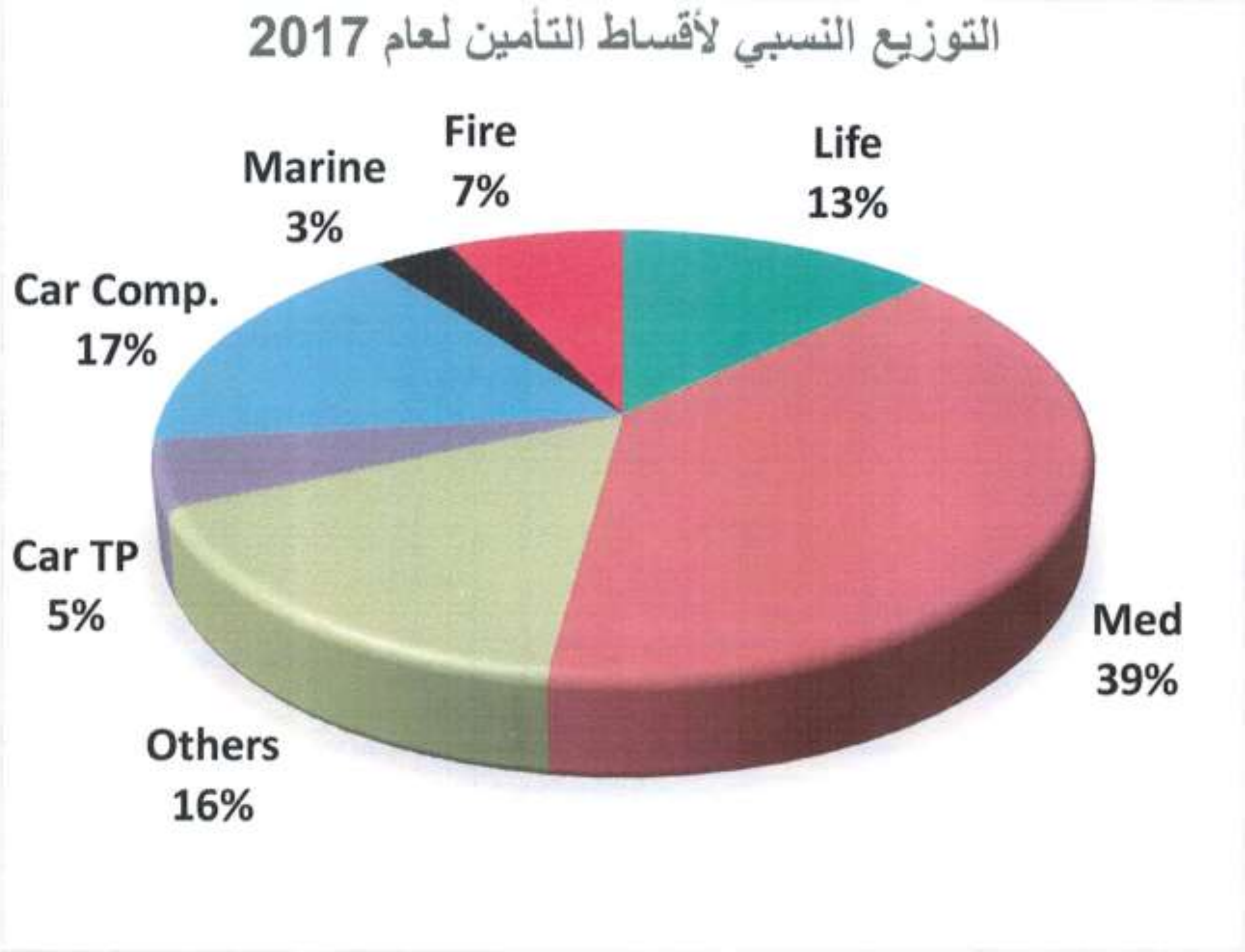
Premiums vs Paid and Outstanding Claims, National Companies – 2017:



Kuwaiti Dinar



Direct Premiums – 2017:



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1. Ministry of Commerce and Industry, State of Kuwait.
2. Kuwait Insurance Federation.
3. Islamic Financial Services Board.
4. The Competition between Takaful and Traditional Insurance Companies, Integrated Takaful Insurance Policy Project, By Prof. Dr. / Abdel Hameed Mahmoud Al-Baali, Prof. of comparative Jurisprudence and Islamic Economy, Head of Economy Department – Faculty of Shariah, Imam Mohammad Bin Saud Islamic University (Previously), Councilor at the Higher Consultancy Committee for Completing the Implementation of Islamic Shariah, Amiri Diwan – State of Kuwait

The End
Thank you
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