

The International Journal of Islamic Business,
Administration and Social Sciences (JIBAS)

Trilingual (Arabic, English, Urdu) (Quarterly)

ISSN: (P) 2788-4317 (E) 2788-4325

Home Page: <http://jibas.org>

APPROVED BY HEC IN Y CATEGORY

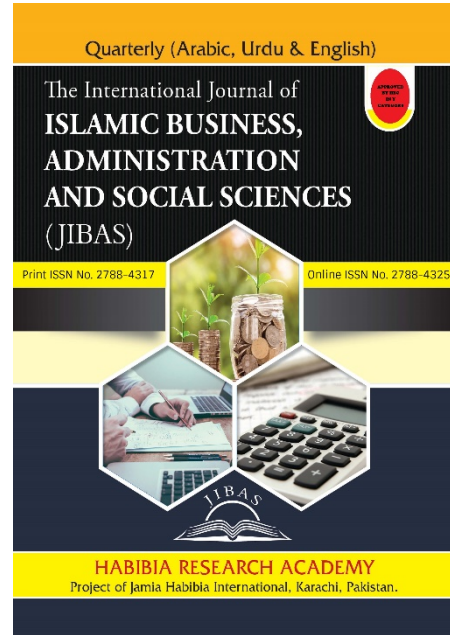
Indexing: IRI (AIU), Australian Islamic Library,
Euro pub.

PUBLISHER HABIBIA RESEARCH ACADEMY

Project of JAMIA HABIBIA INTERNATIONAL,
Reg. No: KAR No. 2287 Societies Registration
Act XXI of 1860 Govt. of Sindh, Pakistan.

Website: www.habibia.edu.pk,

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TOPIC:

AWARENESS & COMPARIISON BETWEEN TAKAFUL & INSURANCE

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HOW TO CITE: Shaikh, Muhammad Waqar, Bakhtiyar Bano, Momin Fayyaz, and Muhammad Younis. 2021. "AWARENESS & COMPARISON BETWEEN TAKAFUL & INSURANCE". *International Journal of Islamic Business, Administration and Social Sciences (JIBAS)* 1 (2):7-18. <https://jibas.org/index.php/jibas/article/view/15>.

URL: <https://jibas.org/index.php/jibas/article/view/15>

Vol. 1, No.2 || April –June 2021 || P. 7-18

Published online: 2021-06-30

QR CODE



AWARENESS & COMPARISON BETWEEN TAKAFUL & INSURANCE*Muhammad Haris Azfar, Bakhtiyar Bano, Momin Fayyaz, Muhammad Younis***ABSTRACT:**

Takaful, is the most prevailed system of adjustment of modern banking with the Islamic banking. We create a mutual system, based on cooperation of Muslims with each other to cater the loss of anyone person. It's the most authentic system devised to enable Islamic transactions within Muslims. The Modern world, not only brought us the gifts like globalization and capitalism, but also provided us with the high-leveled problematic, *Riba*. *Riba* has been all over the place, may it be anyone's buying and selling for normal purposes, business, food, health, security, and etcetera. There has now developed a scenario in which everyone finds himself caught. In such an *Interest* based system, the Muslim was provided much hard time than any other civilization. It is so because of the strong religious prohibitions about Interest in Islam. The Ulemas, Scholars, then had to devise a method to '*adjust*' this system into the modern era. It was also important because everything was encapsulated by the capitalist economy so much, that the escape from it was not possible. We therefore required a strong alternative to enable our existence in the world and flourish. It was then seen that, Islam pays an important light upon helping each other in different aspects of the society. It is, so that the society progress and there would be a harmony in the society. Not only has the society progressed but also that the society would have peace and brotherhood among each other. Every person would be loyal and keen about his brothers' problems and tribulations. This idea became the basis of the Islamic Banking in the Modern Era, and an upholding effort to sustain in the present world with the modern economy.

KEYWORDS: Takaful, Comparison of Takaful and Insurance, Islamic Banking, awareness of Islamic finance, profit and loss sharing.

INTRODUCTION: Takaful (تَكَافُل) is an Islamic Insurance concept which is grounded in Islamic *muamalat* (Islamic Banking), observing the rules and regulations of Islamic law. This concept has been practiced in various forms for over 1400 years. Islamic jurists resolved that the system of insurance, which falls within the confines of Islamic framework, should be founded on the concept of al-Takaful. An Islamic insurance transacting is a policy of mutual co-operation, solidarity and brotherhood against unpredicted risk or catastrophes, in which the parties involved are expected to contribute genuinely. The nature of the principles of Takaful is fundamentally different from the principles of conventional insurance.

ORIGINS OF TAKAFUL: Upon close examination of the primary sources of guidance for Muslims (Holy Quran Sunnah and Hadith), it becomes apparent that members of the first Islamic community 14 centuries ago practiced successful schemes of cooperative risks sharing that originated even before the advent of Takaful. Early precursors were developed in response to perils and risks associated with long-distance trade via caravans or sea voyage and included: *hifl* (confederation), *aqila* (pooling of resources), and *Daman al tarik* (surety) that gradually evolved into a system of community self-help and financial assistance, which Prophet Muhammad (PBUH)

validated as Takaful. In the early period of community building in Medina (Hijrah 1 thru 20) there were three instances in which Prophet Muhammad (PBUH) employed an insurance mechanism to solve daily societal issues. In the first constitution in Medina of 622 BC, there were codified references to social insurance replying upon practices such as al-diyah and al-aqila (wergild or blood-money to rescue an accused in accidental killings), fidyah (ransom of prisoners of war) and cooperative schemes to aid the needy, ill and poor.

Founded upon these and other findings within primary Islamic sources, religious scholars have issued numerous judicial opinions and Fatwas confirming that Takaful as cooperative risk sharing is acceptable for Muslims.

For example:

- Fatwa issued by Higher Council of Saudi Arabia in 1397 AH (1976 CE) in favor of Islamic model.
- Fatwa issued by the Fiqh Council of Muslim World League in 1398 AH in favor of Islamic insurance.
- Fatwa issued by the Fiqh Council of the Organization of the Islamic Conference in 1405 AH in favor of insurance under Islamic model.
- The Grand Counsel of Islamic Scholars in Mekkah, Maja Al-Fiqh, approved the Takaful system in 1985 as the correct alternative to conventional insurance in full compliance with Sharia.
- Takaful Act of 1984 authorized by the Ulama and Government of Malaysia.

ISLAMIC REFERENCES

These fundamentals are based on the sayings of the Islamic Prophet Muhammad. Based on the hadith and Quranic verses mentioned below, Islamic scholars had decided that there should be a concerted effort to implement the Takaful concept as the best way to resolve these needs. Some of the examples are:

- Basis of Co-operation Help one another in al-Birr and in al-Taqwa (virtue, righteousness and piety): but do not help one another in sin and transgression. (Surah Al-Maidah, Verse 2)
- Allah will always help His servant for as long as he helps others. (Narrated by Imam Ahmed Bin Hambel and Imam Abu Daud)
- Basis of Responsibility The place of relationships and feelings of people with faith, between each other, is just like the body; when one of its parts is afflicted with pain, then the rest of the body will be affected. (Narrated by Imam al-Bukhari and Imam Muslim)
- One true Muslim (Mu'min) and another true Muslim (Mu'min) is just like a building whereby every part in it strengthens the other part. (Narrated by Imam al-Bukhari and Imam Muslim)
- Basis of Mutual Protection By my life, which is in Allah's Power, nobody will enter Paradise if he does not protect his neighbor who is in distress. (Narrated by Imam Ahmad bin Hanbal) The basic fundamentals underlying the Takaful concept are very similar to co-operative and mutual

principles, to the extent that the co-operative and mutual model is one that is accepted under Islamic Law.

- Some Muslims believe insurance is unnecessary, as society should help its victims. Others believe that Muslims should not ignore the fact that they live, trade and communicate with open global systems, and the need for banking and insurance. They believe in creating Muslim-friendly banking systems and a workable insurance framework by which Muslims can compete with non-Muslims in business and have cover in daily life.

CONCEPTUAL FRAMEWORK-:

The concept of insurance (Takaful), according to the jurists, is acceptable in Islam for the following reasons:

- The policyholders would co-operate among themselves for their common good.
- Every policyholder would pay his subscription in order to assist those of them who need assistance.
- It falls under the donation contract which is intended to divide losses and spread liability according to the community pooling system.
- The element of uncertainty is eliminated insofar as subscription and compensation are concerned.
- It does not aim at deriving advantage at the cost of other individuals.

Theoretically, Takaful is perceived as cooperative or mutual insurance, where members contribute a certain sum of money to a common pool. The purpose of this system is not profits but to uphold the principle of "bear ye one another's burden." Commercial insurance is strictly not allowed for Muslims as agreed upon by most contemporary scholars because it contains the following elements:

1. Al-Gharar (Uncertainty).
2. Al-Maisir (Gambling).
3. Riba (Interest).

There are three models and several variations on how takaful can be implemented.

1. Mudharabah Model.
2. Wakalah Model.
3. Combination of both.

Under Islamic law, generally, any transaction that has the following elements: unjustified enrichment, uncertainty, risks, riba would vitiate a contract. Clearly, the contract of insurance under Islamic law would not be valid unless it was free from these elements.

Thus in consonance with the above characteristics the jurists resolved that the system of insurance which falls within the confines of Islamic framework should be founded on the concept of al-Takaful. An Islamic insurance transaction is a policy of mutual co-operation, solidarity and brotherhood against unpredicted risk or catastrophes, in which the parties involved, are expected to contribute genuinely.

ISLAMIC INSURANCE-:

A book by Dr. Aly Khorshid "Islamic insurance, with modern approach to Islamic Banking" Some Muslims believe insurance is unnecessary, as society should help its victims. According to the author of the book, Muslims can no longer ignore the fact that they live, trade and communicate with open global systems, and they can no longer ignore the need for banking and insurance. Aly Khorshid states that the initial clerical apprehensions were overcome to create pioneering Muslim-friendly banking systems, and applies the lessons learnt to a workable insurance framework by which Muslims can compete with non-Muslims in business and have cover in daily life. The book uses relevant Quranic and Sunnah extracts, and the arguments of pro- and anti-insurance jurists to arrive at its conclusion that Muslims can enjoy the peace of mind and equity of an Islamic insurance scheme.

THE CRUCIAL ELEMENTS THAT DEFINE A TAKAFUL SYSTEM-:

At bottom, there are five (5) elements that must co-exist to establish a proper framework for a Takaful system; namely:

- Ne'aa or utmost sincerity of Intention for knowingly following the guidance and adhering to the rule and purposes of Takaful - cooperative risk sharing and mutual assistance.
- Integration of Sharia conditions, namely risk sharing under Ta'awuni principles, coincidence of ownership, participation in management by policyholders, avoidance of Riba and prohibited investments, and inclusion of al Mudharaba and/or al Wakalah principles for management practices.
- Presence of Moral Value and Ethics whereby business is conducted openly in accordance with utmost good faith, honesty, full disclosure, truthfulness and fairness in all dealings.
- No Unlawful Element, that contravenes Sharia and strict adherence to Islamic rules for commercial contract, namely:
 - o Parties have legal capacity and are mentally fit
 - o Insurable interest
 - o Principle of indemnity prevails
 - o Payment of premium is consideration (offer and acceptance)
 - o Mutual consent which includes voluntary purification
 - o Specific time period of policy and underlying agreement
- Appointment of Sharia Advisory Council or Committee to oversee the development and Islamic auditing of the takaful operation.

The bedrock differences between conventional insurance as currently practiced and Islamic cooperative risk-sharing can be briefly summarized in three points:

(A) Takaful is an ethical system with absolute rather than normative values revealed by God (Allah - swt) that are not subject to periodic reinterpretations.

(B) Takaful's main drivers are:

- o Piety {meaning individual purification}.

- o Brotherhood {via Ta'awun or mutual assistance}.
- o Charity {Tabarru or donation}.
- o Mutual Guarantee.
- o Self-sustaining Operations as opposed to profit maximization.

(C) Cooperative risk-sharing and profit-sharing prevails throughout in the primary insurance level as well as in any Re-Takaful arrangements, as opposed to using a brokerage fee-based relationship common in re-insurance.

It should be understood that one fundamental motivating factor for Muslims to utilize a Takaful system is to perform acts of piety... using Tabarru (donation) and Ta'awun (mutual assistance) to promote community well-being as well as achieve individual purification.

“And cover not truth with falsehood; no conceal the truth when you Know (What it is)”.

INSURANCE INTRODUCTION-:

In law and economics, Insurance is a form of risk management primarily used to hedge against the risk of a contingent, uncertain loss. Insurance is defined as the equitable transfer of the risk of a loss, from one entity to another, in exchange for payment. An insurer is a company selling the insurance; an insured, or policyholder, is the person or entity buying the insurance policy. The insurance rate is a factor used to determine the amount to be charged for a certain amount of insurance coverage, called the premium. Risk management, the practice of appraising and controlling risk, has evolved as a discrete field of study and practice.

The transaction involves the insured assuming a guaranteed and known relatively small loss in the form of payment to the insurer in exchange for the insurer's promise to compensate (indemnify) the insured in the case of a financial (personal) loss. The insured receives a contract, called the insurance policy, which details the conditions and circumstances under which the insured will be financially compensated.

HISTORY OF INSURANCE-:

Unpredictability, Each of us lives with it, not knowing what each new day will bring. It is this very uncertainty, which gave way to the development of the business of insurance. In ancient times, farmers of China sent their crops to market on boats. Inevitably, on occasion a boat sank along the way. The farmers began spreading their crops among numerous boats, so that if one boat sank, any one family would only lose a small portion of their crops, thus avoiding financial devastation. The loss was spread among many families, and was therefore manageable for each one. Actual insurance contracts originated in the 13th century with ship owners who wanted to protect themselves against the possibility of catastrophic losses. As before, ships were inevitably lost at sea from time to time. The owners were aware of this, but they could not foresee which ships would be lost at what time. Wealthy individuals agreed to receive a certain amount of money from each ship owner in exchange for a promise to pay for the loss of a ship when it occurred. Insurance is,

in actuality, a social vehicle for spreading the risk of financial loss among a large group of people, thus making a loss manageable for any one person of that group. As opposed to the risk associated with investments, risk with regard to insurance matters refers to the possibility of loss. Note that it is not the loss itself, but the possibility of a loss. There are two types of risk, only one of which can be insured; speculative risk and pure risk. Speculative risk affords the opportunity for gain as well as the possibility of loss. Gambling and stock market investments are two common examples. This type of risk is not insurable. Pure risk has the possibility of loss only; thus, it is insurable. The purpose of insurance is to restore the insured to their original financial position, not to provide an opportunity for making a profit. There are several ways of managing, or coping with, risk. It may be reduced or avoided altogether by examining its causes and eliminating them where possible. Risk can be retained when a person decides to assume financial responsibility for specific events. Or risk may be transferred to another party, such as through an insurance contract.

In the early days of insurance people could obtain an insurance policy on anyone, even complete strangers. If that person died, the policyholder reaped the benefit of the policy with no apparent financial or emotional loss. You can easily imagine the possibilities of a situation like this. (Can you spell murder?) To close this somewhat glaring loophole, a basic governing rule of insurance was instituted which states that an individual must have a legitimate interest in the preservation of the life or property insured, before that individual can benefit from its insurance. This requirement is known as insurable interest. As you can guess, insurance has evolved from its very early days. Its complexities can, at times, be quite confusing. Its basic premise, however, remains unchanged; to spread risk, thus making loss, when it occurs, manageable.

PRINCIPLES OF INSURANCE

Main principles of Insurance:

- Utmost good faith
- Indemnity
- Subrogation
- Contribution
- Insurable Interest
- Proximate Cause

Utmost Good Faith (Uberrimae Fides) As a client it is your duty to disclose all material facts to the risk being covered. A material fact is a fact, which would influence the mind of a prudent underwriter in deciding whether to accept a risk for insurance and on what terms. The duty to disclose operates at the time of inception, at renewal and at any point mid-term.

Indemnity: On the happening of an event insured against, the Insured will be placed in the same monetary position that he/she occupied immediately before the event-taking place. In the event of a claim, the insured must:

- Prove that the event occurred

- Prove that a monetary loss has occurred
- Transfer any rights which he/she may have for recovery from another source to the Insurer, if he/she has been fully indemnified.

Subrogation: The right of an insurer which has paid a claim under a policy to step into the shoes of the insured so as to exercise in his name all rights he might have with regard to the recovery of the loss which was the subject of the relevant claim paid under the policy up to the amount of that paid claim. The insurer's subrogation rights may be qualified in the policy.

In the context of insurance subrogation is a feature of the principle of indemnity and therefore only applies to contracts of indemnity so that it does not apply to life assurance or personal accident policies. It is intended to prevent an insured recovering more than the indemnity he receives under his insurance (where that represents the full amount of his loss) and enables his insurer to recover or reduce its loss.

Contribution: The right of an insurer to call on other insurers similarly, but not necessarily equally, liable to the same insured to share the loss of an indemnity payment i.e. a travel policy may have overlapping cover with the contents section of a household policy. The principle of contribution allows the insured to make a claim against one insurer who then has the right to call on any other insurers liable for the loss to share the claim payment.

Insurable Interest: If an insured wishes to enforce a contract of insurance before the Courts he must have an insurable interest in the subject matter of the insurance, which is to say that he stands to benefit from its preservation and will suffer from its loss. In non-marine insurances, the insured must have insurable interest when the policy is taken out and also at the date of loss giving rise to a claim under the policy.

Proximate Cause: An insurer will only be liable to pay a claim under an insurance contract if the loss that gives rise to the claim was proximately caused by an insured peril. This means that the loss must be directly attributed to an insured peril without any break in the chain of causation.

TYPES OF INSURANCE

Auto Insurance: Auto insurance protects the policyholder against financial loss in the event of an incident involving a vehicle they own, such as in a traffic collision.

Coverage typically includes:

1. Property coverage, for damage to or theft of the car;
2. Liability coverage, for the legal responsibility to others for bodily injury or property damage;
3. Medical coverage, for the cost of treating injuries, rehabilitation and sometimes lost wages and funeral expenses.

Most countries, such as the United Kingdom, require drivers to buy some, but not all, of these coverage's. When a car is used as collateral for a loan, the lender usually requires specific coverage.

Home insurance: Home insurance provides coverage for damage or destruction of the policyholder's home. In some geographical areas, the policy may exclude certain types of risks,

such as flood or earthquake that require additional coverage. Maintenance-related issues are typically the homeowner's responsibility. The policy may include inventory, or this can be bought as a separate policy, especially for people who rent housing. In some countries, insurers offer a package which may include liability and legal responsibility for injuries and property damage caused by members of the household, including pets.

Health insurance: Health insurance policies issued by publicly funded health programs, such as the UK's National Health Service will cover the cost of medical treatments. Dental insurance, like medical insurance, protects policyholders for dental costs. In the U.S. and Canada, dental insurance is often part of an employer's benefits package, along with health insurance.

Life: Life insurance provides a monetary benefit to a descendant's family or other designated beneficiary, and may specifically provide for income to an insured person's family, burial, funeral and other final expenses. Life insurance policies often allow the option of having the proceeds paid to the beneficiary either in a lump sum cash payment or an annuity.

Property: Property insurance provides protection against risks to property, such as fire, theft or weather damage. This may include specialized forms of insurance such as fire insurance, flood insurance, earthquake insurance, home insurance, inland marine insurance or boiler insurance. The term property insurance may, like casualty insurance, be used as a broad category of various subtypes of insurance, some of which are listed below:

- Aviation insurance protects aircraft hulls and spares, and associated liability risks, such as passenger and third-party liability. Airports may also appear under this subcategory, including air traffic control and refueling operations for international airports through to smaller domestic exposures.
- Boiler insurance (also known as boiler and machinery insurance, or equipment breakdown insurance) insures against accidental physical damage to boilers, equipment or machinery.
- Builder's risk insurance insures against the risk of physical loss or damage to property during construction. Builder's risk insurance is typically written on an "all risk" basis covering damage arising from any cause (including the negligence of the insured) not otherwise expressly excluded. Builder's risk insurance is coverage that protects a person's or organizations insurable interest in materials, fixtures and/or equipment being used in the construction or renovation of a building or structure should those items sustain physical loss or damage from an insured peril.
- Crop insurance may be purchased by farmers to reduce or manage various risks associated with growing crops. Such risks include crop loss or damage caused by weather, hail, drought, frost damage, insects, or disease.
- Earthquake insurance is a form of property insurance that pays the policyholder in the event of an earthquake that causes damage to the property. Most ordinary home insurance policies do not cover earthquake damage. Earthquake insurance policies generally feature a high deductible. Rates

depend on location and hence the likelihood of an earthquake, as well as the construction of the home.

□ Fidelity bond is a form of casualty insurance that covers policyholders for losses incurred as a result of fraudulent acts by specified individuals. It usually insures a business for losses caused by the dishonest acts of its employees.

□ Flood insurance protects against property loss due to flooding. Many insurers in the U.S. do not provide flood insurance in some parts of the country. In response to this, the federal government created the National Flood Insurance Program which serves as the insurer of last resort.

□ Home insurance, also commonly called hazard insurance, or homeowners insurance (often abbreviated in the real estate industry as HOI), is the type of property insurance that covers private homes, as outlined above.

□ Landlord insurance covers residential and commercial properties which are rented to others. Most homeowners' insurance covers only owner-occupied homes.

- Marine insurance and marine cargo insurance cover the loss or damage of vessels at sea or on inland waterways, and of cargo in transit, regardless of the method of transit. When the owner of the cargo and the carrier are separate corporations, marine cargo insurance typically compensates the owner of cargo for losses sustained from fire, shipwreck, etc., but excludes losses that can be recovered from the carrier or the carrier's insurance. Many marine insurance underwriters will include "time element" coverage in such policies, which extends the indemnity to cover loss of profit and other business expenses attributable to the delay caused by a covered loss.

- Surety bond insurance is a three-party insurance guaranteeing the performance of the principal.

- Terrorism insurance provides protection against any loss or damage caused by terrorist activities. In the U.S. in the wake of 9/11, the Terrorism Risk Insurance Act 2002 (TRIA) set up a federal Program providing a transparent system of shared public and private compensation for insured losses resulting from acts of terrorism. The program was extended until the end of 2014 by the Terrorism Risk Insurance Program Reauthorization Act 2007 (TRIPRA).

RELIGIOUS CONCERNS: Muslim scholars have varying opinions about insurance. Insurance policies that earn interest are generally considered to be a form of riba (usury) and some consider even policies that do not earn interest to be a form of gharar (speculation). Some argue that gharar is not present due to the actuarial science behind the underwriting. Jewish rabbinical scholars also have expressed reservations regarding insurance as an avoidance of God's will but most find it acceptable in moderation. Some Christians believe insurance represents a lack of faith and there is a long history of resistance to commercial insurance in Anabaptist communities (Mennonites, Amish, Hutterites, and Brethren in Christ) but many participate in community-based self-insurance programs that spread risk within their communities. <http://en.wikipedia.org/wiki/Insurance>

BRIEF COMPARISON BETWEEN TAKAFUL AND CONVENTIONAL INSURERS

Insurance and Takaful - are the following items:

- Sources of Capital and Returns to Capital
- Organizing principle; i.e. Relationship among participants themselves and between Participants and the Takaful Operator.
- Treatment of Expenses and Liability for Claims
- Zakat and Charitable features - how to cleanse profits
- Funds management - pooled or unitized
- Investment of Premiums in accordance to Sharia
- Dissolution - who ends up with any surplus capital
- Regulations, Taxation and Auditing

O Agents and Brokers are typically independent from insurer and paid a fee from the premium charged to policyholders that is not disclosed that is not disclosed.

Agents are employees of the Takaful and any sales commission should be disclosed.

Investment of premiums conducted by insurer with no involvement by policyholders.

Takaful contract specified under principles of al Mudharabah how premiums will be invested and how results are shared. Under al Wakalah, similar practice plus Participant can direct his investments into a range of unitized funds.

Insurer invests premiums consistent with profit-motive

Takaful invests premiums in accordance with with no moral guidelines; hence co-existence of Al Riba Islamic values and Shariah guidelines. and Al Maisir.

Dissolution - reserves and excess/surplus belong to the shareholders. Dissolution - reserves and excess/surplus could be returned to Participants, although consensus opinion prefers donation to charity.

Taxes - subject to local, state and federal taxes. Taxes - subject to local, state and federal taxes (if any) plus obligated to arrange annual tithes (Zakat) donations to charity. Benefits paid from general insurance account owned by insurer. Benefits paid from contributions (Al tabarru) made by participants as mutual indemnification.

Accounting consistent with GAAP and prevailing statutory rules Auditing for uniform application of accounting standards. Accounting standards consistent with national rules (with may be GAAP) plus prevailing statutory rules. Auditing same standards plus conformance with Islamic rules; typically with Sharia Advisory oversight.

CONCLUSION: To summarize, there are seven main obstacles to rapid evolution and expansion of a global Takaful industry;

- How will takaful operators react to the sweeping changes impacting the conventional (re) insurance sector such as global consolidation, demutualization and the Internet revolution?
- How to respond to advancing disintermediation whereby customers are redefining distribution channels and their information needs.

- Massive scale is required today in order to compete. How to attract capital needed into the local Takaful sector.
- Product innovation is accelerating. Forward-thinking not imitation is required
- How to widen the scope of Shari'ah dialogue , both to include risk securitizations and other innovations as well as to help focus Islamic scholarly research and reflection on such issues.
- Emergence of scholarly consensus for models of Takaful Operations that is sensitive to regional differences and local governmental regulations yet adhere strictly to the fundamental cooperative principles of Takaful.
- Establishment of a global Retakaful facility in order to increase underwriting capacity and expertise available to indigenous Takaful operators.

In conclusion, Islamic Finance and Islamic Takaful are ethical financing and cooperative risk protection methods that are superior alternatives precisely because they reinvigorate human capital; emphasize personal dignity, community self-help, and economic self-development. Generating manifold benefits for all participants. Islam is an integrated way of life. Thus, interest-free financing and Takaful are mutually reinforcing systems that promote at once economic efficiency, communal risk-sharing and individual rewards through self-purification. In as much as the Takaful system resolves around active participation by members of the community, it is imperative that public awareness be enhanced. As Muslims and non-Muslims alike come to understand the real benefits of Takaful and cooperative risk sharing, the evolution of the Takaful industry will accelerate making the projections described herein overly conservative.

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