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Analysis of *Tabarru`* Principle in Takaful Contract: Malaysian Experience

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Abstract. Under Shariah law, conventional insurance is prohibited due to the elements of *gharar*, *maysir* and *riba* in its implementation. Instead, takaful was introduced to replace conventional insurance. In order to ensure that takaful operates within Shariah law, a takaful contract is developed based on the concept of *tabarru`*. Although the *takaful* industry has been around for the past 26 years in Malaysia, the type of contract that should be applied in the creation of a *tabarru`* account has yet to be specified. The types of contracts that can potentially be used include those created based on the principles of *hibah*, *waqf*, *sadaqah* or any other similar *tabarru`* contracts. This paper argues that *tabarru`* contracts should use the *sadaqah* principle. This argument is based on the nature of the *sadaqah* principle which does not have strict requisites and conditions, unlike other *tabarru`* contracts. After suggesting the use of the *sadaqah* principle, this paper analyses ways in which *sadaqah* can be applied in the takaful contract. The use of the *sadaqah* principle to create *tabarru`* accounts, thus eliminating elements of interest, uncertainty and gambling is the central argument addressed in this paper.

Keywords: takaful, *tabarru`*, *sadaqah*, Islamic finance, Islamic insurance

1. Introduction

It's been established among scholars that the general concept of insurance does not contradict Shariah law because insurance is a mechanism that can manage and mitigate pecuniary losses associated with theft,

accident, poor health and so on. However, local¹ and international Muslim scholars have rejected insurance

as its implementation involves *riba*, *gharar* and *maysir*. Elements of *riba*, *gharar* and *maysir* exist because

conventional insurance utilises the contract of sale and purchase (Wan Marhaini et al. 2008). For example, if

an insured party purchases an insurance policy that provides a RM50,000 cover, paying a monthly premium

of RM50 for a period of 20 years, but dies after one year, as a result, his family will receive RM50,000 in compensation. The RM50,000 received by his family contains *riba* under Islamic law of transaction because

any money-for-money exchange which involves any delay period or excess quantity in return is considered

as *riba*.

As such, in order to provide Shariah-compliant insurance for Muslims, the key modification that needs to be made on the insurance policy is the substitution of the sale and purchase contract with a donation-based

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¹ In Malaysia, Muslim scholars also share the same opinion. The National Council for Islamic Religious Affairs of Malaysia for instance issued a fatwa in 1979 that prohibits life insurance ¹ as it contains *gharar*, *maysir* and *riba*. See http://www.efatwa.gov.my/jakim/keputusan_view.asp?keyID=96, 18 April 2009. There is no official fatwa issued on general insurance.

However most scholars also do not accept general insurance because of the use of "sale and purchase" contract in the insurance policy which also results in *riba*, *gharar* and *maysir*.

contract with a condition of compensation (al-Qaradawi 1985, Engku Rabiah & P.Odierno, 2008). In the Arabic language the word *tabarru'*, which means 'donation', is also used to refer to donation-based contracts.

Hence, the fundamental difference between conventional insurance and takaful (Islamic insurance) is the element of donation (*tabarru'*) (Engku Rabiah & P.Odierno, 2008). The utilisation of *tabarru'* contracts makes the transaction permissible and valid according to Shariah law because when a contract is charitybased

and not exchange-based, the rule against uncertainty (*gharar*) cannot be strictly applied and the existence of *gharar* in this case can be tolerated (Saiful & Wan Marhaini, 2003, Engku Rabiah & P.Odierno, 2008, Asmak et al., 2008,)

In the management of takaful contribution, takaful operators divide the premium into two separate accounts, namely the participant's account and *tabarru'* account. The participant's account belongs solely to

the participant and the funds in this account will be put into investment by the takaful operator so as to generate profits. In a *wakalah* model, profits generated from these accounts belong solely to the participant

and the takaful operator receives a management fee for the management service they provide (Engku Rabiah

& P.Odierno, 2008). In a *mudarabah* model, the profits are shared between the participant and the takaful operator based on a pre-agreed profit ratio (Engku Rabiah & P.Odierno, 2008).

Meanwhile, a *tabarru'* account holds contributions from all participants who purchase the policy. This fund is also put into investment and participants receive the profits from the investments made by the takaful

operator (Joni Tamkin, 2008). Funds from this account are used if any misfortune befalls any of the participants within the duration of the contract period. For example, if a participant becomes permanently invalid, he or she will receive financial assistance sourced from the *tabarru'* account. Or should the participant pass away, his or her family will receive financial compensation sourced from the *tabarru'* account.

2. *Tabarru'* Contract in Takaful Policy

2.1. Definition of *tabarru'*

Early Muslim scholars such as al-Sharbini (1997), Ibn Rushd (1994) and al-Bahuti (1997) did not specifically discuss or define the *tabarru'* principle. However, the word *tabarru'* has always been used when

discussing *waqf*, *hibah*, and other types of contract classified as *tabarru'* contracts. All *tabarru'* contracts noted in their discussions refer to a form of 'voluntary contract' whereby the party initiating the contract expect nothing in return (no due considerations) from the other party. As such, it can be summarised that a

tabarru' contract is one made voluntarily whereby only one party delivers a good or service without due consideration from the other party. This summarisation is further strengthened by the definition put forward

by Qal'aji, Qunaibi & Khotob (1996) which describes *tabarru'* as a contract of gratuity or charity.

2.2. Is the *tabarru'* contract clearly specified in takaful policy?

In takaful contracts, premiums paid by participants are divided into two accounts; the first account is for the participant's savings while the second account is for the *tabarru'* fund. The takaful operator will invest

the money in the first account into any suitable Shariah-compliant instruments. Once the contract reaches maturity or if the participant wishes to terminate the policy, the participant will get all the money collected

and profits derived from investments made from this account. The second account, which is *tabarru'* fund, is

used as a source of donation which is channelled to any of the participants should they experience a misfortune. For this reason, in family takaful for example, when a participant passes away and the family is

given compensation, this compensation is taken out of the *tabarru'* fund. Hence under this circumstance, even though the participant's family receives RM50,000.00 in compensation whilst the participant only paid

RM50 per month for the policy, the issue of *riba* does not arise because the money given to the family is based upon the principle of *tabarru'* or donation.

In its practice in Malaysia, the word *tabarru'* is used in takaful policies. However, as the word *tabarru'* is a general term which does not point to any specific type of contract, no detailed description is available on

the specific nature of a *tabarru'* contract or the principle used as the foundation for *tabarru'* accounts.

According to Hailani Muji Tahir and Sanep Ahmad (2009), under the Islamic law of transaction, there are a

few types of contracts which are regarded as *tabarru'* contracts, such as *hibah* (inter vivos), *waqf* (bequest)

and *sadaqah* (donation). Each contract has its own rules and conditions which must be adhered to when one

applies that type of contract. Hence, in takaful policies, the word *tabarru'* used in the contract has yet to be

specified as a *waqf*, *hibah*, *sadaqah* or any other forms of contract recognised as *tabarru'*.

Considering the absence of a clear definition of *tabarru'* contract in takaful policies, efforts have been made by some quarters to try and specify the definition of *tabarru'* contracts. For example, Al-Qurahdagi

(2004) proposed the use of *hibah al-thawab*, *al-umra* and *al-ruqba* to define a *tabarru'* contract.

Meanwhile,

Majelis Ulama Indonesia (MUI) defines *tabarru'* contracts as *hibah*, whereas Ma'sum Billah (2001) proposes that it is *al-musahamah*.

In our opinion, defining the *tabarru'* contract as *hibah* is inappropriate due to Shariah issues that arise with the use of the term *hibah*. With the use of *hibah bi al-thawab* contract definition, as proposed by Al-Qurahdagi (2004), the transaction involves the exchange of premium and compensation of different amounts, which constitutes *riba*. The same goes for the suggestion put forward by Ma'sum Billah on the use

of *al-musahamah* principle, which is also unsuitable because *al-musahamah* refers to a partnership contract.

The established use of partnership contracts such as *mudarabah* has raised many issues in the past, leading

the industry to change its direction and opt for the use the *waqf* principle as per the current practice in Pakistan (Imran Usmani, 2006), or a combination of *wakalah* and *tabarru'* principles as practiced by Takaful

Ikhlas in Malaysia (<http://www.takaful-ikhlas.com.my/corporateProfile/takafulModel.asp>., access 12 Dec 2009)

2.3. Why should the *Sadaqah* principle be used in takaful contracts?

In order to fulfil the need for a definition of a *tabarru'* contract in the takaful industry in Malaysia, we are of the opinion that the most appropriate principle to apply is the principle of *sadaqah* which does not have rigid or strict rules and conditions. In addition, taking into consideration the spirit of takaful, which is to

help and protect each other when a misfortune occurs, we believe that *sadaqah* is the most suitable principle

for use in defining a *tabarru'* contract.

There are some who assume that *sadaqah* is something that is given by the rich to the poor. This assumption is misleading. According to al-Sharbini (1997), *sadaqah* should also be given to the rich, just as it is given to those who are less fortunate or are in need such as travellers or those who are ill. This means that the concept of *sadaqah* has a wide scope and is not limited solely as a means of aid to the poor. The use of the *sadaqah* principle in takaful contracts is also quite befitting in the opinion of al-Sharbini (1997). This is because the parties involved mutually agree to give *sadaqah* in order to help each other should any one of them fall into misfortune.

Furthermore, under the *sadaqah* principle, the issues arising from the status of the money in the *tabarru`* account, the status of compensation awarded to the family of the insured when he dies, and the distribution of surplus among the participants and the takaful company, can be settled in line with Shariah law. As mentioned earlier, when participants join a takaful scheme, in reality they agree to donate part of their funds to the *tabarru`* account whereby funds collected in this account will be used to help the takaful participants and their families. This account is in fact an entity in itself, which is known as *shakhsiyyah i`tibariyyah* (legal entity). It is similar to *baitul mal* or *waqf*, which are acknowledged by Muslim scholars as *shakhsiyyah i`tibariyyah* (Al-Qurahdaghi, 2004). If the account is a legal entity in itself, this means that the content of this account 'belongs' to that account and not to the participants. What the authors wish to emphasise here is: as long as funds donated into this account is not distributed in aid of participants or their families based on the agreed policy terms and conditions, it belongs to the account itself and not to the participants or their families. The status of the fund is the same as *zakat* funds in *baitul mal*; as long as it remains in *baitul mal* and not used in aid of Muslims who have rights to the fund, the fund belongs to *baitul mal*.

In addition, *zakat* funds can only be given to the eight *asnaf*, it cannot be distributed to anyone other than these eight *asnaf*. The same applies to funds collected in the *tabarru`* account, whereby it is jointly donated by the takaful participants and can only be distributed to these participants when they experience a misfortune, in accordance with the agreed terms and conditions of the policy. As such, funds distributed to the family of a deceased participant cannot be regarded as inheritance because as soon as the funds are paid into the *tabarru`* account, it is no longer the property of the participant.

With regard to the issue of surplus, the best way to manage it is to bring forward the amount to the following year or donate it to any suitable charitable organisations such as an orphanage. However, it is not against Shariah law to re-distribute the surplus amount back to the participants, although some may feel that this hints of insincerity on the part of the participants in their donation. However, in line with the *hadith* from

Rasulullah s.a.w, "شروطهم عند المسلمين" (Muslims are bound by the lawful conditions), this issue is irrelevant if

the matter has already been agreed upon by all parties involved in the *takaful* scheme right from the beginning. It's also not against Shariah law if the takaful operators intend to retain some portions of the surplus as a fee for their roles in managing the surplus fund. As explained earlier, the donation model is

much easier to implement because donations do not carry overly strict rules and conditions compared to other types of *tabarru`* contracts.

2.4. Modus operandi for *sadaqah*-based family takaful

The modus operandi for *sadaqah*-based family takaful is illustrated in Figure 1 :

Fig. 1:

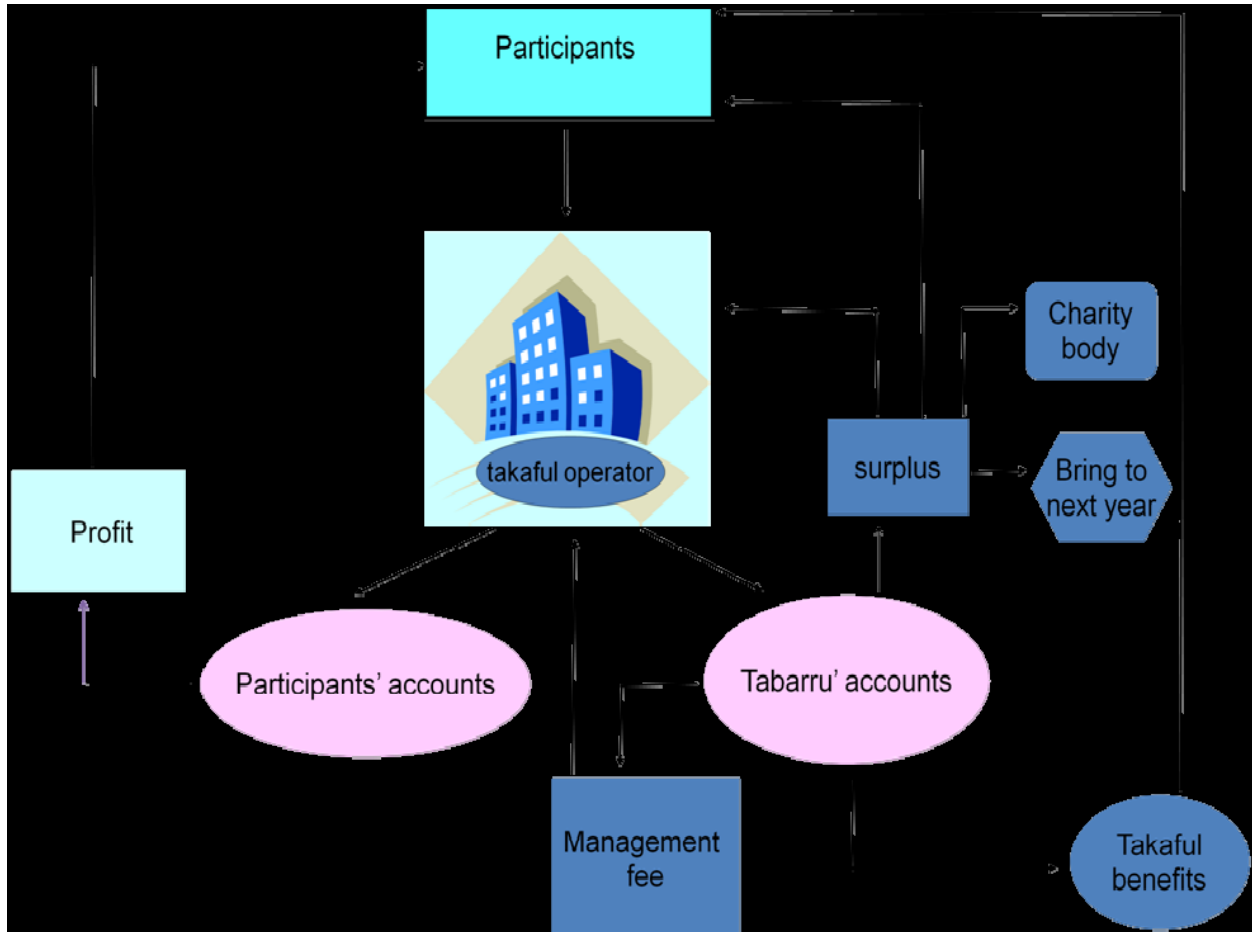


Fig. 1: Modus Operandi for *Sadaqah*-based Family Takaful Model

When participants enter into a family takaful contract, they agree to appoint the takaful operator as a representative who manages their funds and all matters relating to the takaful operation. In this instance, the contractual relationship between the takaful operator and the participants is based on the *wakalah* contract.

As such, the takaful operator is entitled to receive a fee for all work undertaken as a representative who manages the takaful participants' funds.

Participants also agree that any premium or instalment paid by them will be divided into two accounts - the participants' account and the *tabarru`* account. All funds in the participants' accounts belong to the respective participants. As per a *wakalah* contract, the takaful operator will invest this fund into Shariahcompliant instruments on behalf of the participants. Any profits derived from this investment activity belong to the participants. As such, should the participant pass away, all funds collected in the participant's account

will be distributed to the participant's heirs in accordance with *faraid* law. Participants also agree to donate part of their premium or instalment into a *tabarru`* account according to a pre-agreed schedule of payment. The company must clearly state the exact amount to be put into this *tabarru`* account. The takaful company must also clarify to the participants what the *tabarru`* account funds will be used for, aside from the financial assistance given to participants who experience a misfortune. For example, funds from the *tabarru`* account may be used to pay for retakaful, for management costs and so on. Such a clause must be clearly expressed in the takaful policy so that all plans relating to the *tabarru`* account funds will be agreed to by the takaful participants beforehand. Surplus in the *tabarru`* fund, if any, can be managed by bringing it forward to the following year, donating it to Shariah-compliant charitable bodies or distributing it back to the participants.

3. Conclusion

In conclusion, we recommend that the sadaqah principle be used in defining the *tabarru`* contract used in takaful operation. This is because the use of this principle can resolve a number of Shariah issues which have been questioned before, such as the issue of compensation gained by the family of a policy holder upon his demise and the issue of surplus funds in *tabarru`* accounts. It is important to define the *tabarru`* contract using the appropriate principle because each contract has its own rules and conditions under the Islamic law of transaction, which can influence the validity and permissibility of the takaful policy.

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