

Singapore Management University Institutional Knowledge at Singapore Management University

Research Collection School Of Accountancy

School of Accountancy

8-2006

Evidence on the Relationship between Takaful Insurance and Fundamental Perception of Islamic Principles

Ramin Cooper Maysami
University of North Carolina at Pembroke

John Joseph Williams
Singapore Management University, jjwilliams@smu.edu.sg

DOI: <https://doi.org/10.1080/17446540500461778>

Follow this and additional works at: https://ink.library.smu.edu.sg/soa_research

Part of the [Accounting Commons](#), [Insurance Commons](#), and the [Religion Law Commons](#)

Citation

Maysami, Ramin Cooper and Williams, John Joseph. Evidence on the Relationship between Takaful Insurance and Fundamental Perception of Islamic Principles. (2006). *Applied Financial Economics Letters*. 2, (4), 229-232. Research Collection School Of Accountancy.

Available at: https://ink.library.smu.edu.sg/soa_research/269

This Journal Article is brought to you for free and open access by the School of Accountancy at Institutional Knowledge at Singapore Management University. It has been accepted for inclusion in Research Collection School Of Accountancy by an authorized administrator of Institutional Knowledge at Singapore Management University. For more information, please email libIR@smu.edu.sg.

Evidence on the relationship between Takaful insurance and fundamental perception of Islamic principles

Ramin Cooper Maysami

School of Business, University of North Carolina at Pembroke, 1 University Drive, P.O. Box 1510, Pembroke, NC 28372, USA

John Joseph Williams

Singapore Management University, Singapore

Published in Applied Financial Economics Letters, 2006, 2 (4), 229-232.

doi: [10.1080/17446540500461778](https://doi.org/10.1080/17446540500461778)

Abstract

One of the complexities overarching the concept of Islamic insurance is anchored in the belief system pertaining to fundamental Islamic Law, while another is embedded in the role of profit within the takaful contract. The purpose of this study is to empirically explore the association between the awareness of the existence of Islamic insurance (takaful) and religious perceptions of this financial service.

I think the way to move will be to identify more people within the Malay/Muslim community who have an interest in this type of insurance. Perhaps AMP [Association of Muslim Professionals] can do a survey to produce statistics to show that there is a potential demand for this type of service before approaching the banks and insurance companies. Up to now my impression is that the demand is either unknown or not sufficiently known for the insurance companies themselves to initiate something.

Dr Richard Hu

Former Finance Minister, Republic of Singapore¹

1. Introduction

According to the teachings of Islam, Muslims are to accept any misfortune that befalls them as the will of *Allah*, but they are also exhorted to take positive steps to minimize unfortunate events. An insurance contract reduces the risk of loss due to accident or ill-fated circumstance. Outside of Islam, this undertaking is unproblematic; however, its conformity to Islamic law, or *Shariah*, is debated. Muslim scholars differ in their views on the permissibility (*halal*) or prohibition (*haram*) of insurance.

Some accept insurance in its traditional form as part and parcel of the necessary development of modern Islamic concepts. Based on the established maxim that the original lawful position on any matter is permissibility until there is evidence prohibiting it, they assert there is no injunction (*nass*) against conventional insurance and it should be allowed (*mubah*). Furthermore, Islam describes the universe as an adornment of Allah (*The Holy Quran*, 7:32), and Muslims are allowed to use the resources of the universe, and all that is needed to facilitate this usage are thus permissible (*The Holy Quran*, 45:13).

Others argue that insurance should be prohibited following the view that 'each contract whose consequences are held in ignorance includes a form of aleatory'. The presence of insurable interest would not save the commercial insurance contract from *Shariah* law because the outcome of an insurance contract is, by its very nature, unknown. Such a contract would possess the prohibited elements of uncertainty of outcome (*gharar*) and gambling (*maisir*).

In addition, when purchasing a conventional insurance policy, the policyholder is assured of promised returns at the end of the insurance term if timely premium payments are made. Once again, the outcome may contravene the spirit of *Shariah* law, which prohibits a predetermined return, or *riba*.

II. The Islamic Alternative

The basic motive for *takaful* under the Islamic value system is to bring equity to all parties involved, and the objective of the contract should be to help other policyholders through bad times. Earning profits should not be the main goal, although *sharing* any profits generated incidentally is acceptable (Maysami and Kwon, 1999).

In accordance with the principle of joint guarantee (*tabarru*) to help others, each policyholder willingly agrees to give a portion of the paid premium to other policyholders who may be in need of financial assistance. The claimants, in turn, must realize that the amount paid to them has come from fellow policyholders, and should not indulge in any profiteering and self-serving activities that may be detrimental to the interests of the other policyholders.

To claim benefits from a life insurance policy, only proof of death is needed. The cause of death does not matter because it is the will of Allah that determines all death. If the assured dies before the maturity of the policy, the beneficiary, acting as a trustee, would claim the total premiums paid and the share of profits and would distribute it among the heirs of the assured deceased according to the principles of inheritance (*mirath*) and bequest (*wasiyah*). In addition, a donation from the company's charitable fund to the beneficiary/heirs of the assured is possible based on their financial needs. If the assured is alive upon the maturity of the policy, he may claim the total amount of premiums paid, together with a share of the profits.

The concept of *Al-mudarabah* prescribes that all policyholders must agree to share profits (or losses) from the undertaking (Maysami *et al.* 1997). Similarly, agents who sell *takaful* life policies would not be paid a commission but receive a salary equal to a share of the profits made by the company as well as dividend and bonus payments, if any. These same conditions apply to the management. This would result in a reduction in moral hazard issues leading to more confidence in the fund (Billah, 1996).

Every *takaful* policyholder has the right to know how their money is utilized, how the surrender value is computed, and how profits from various investments are divided. As a matter of fact, *takaful* policyholders must be certain that neither returns nor funds paid out in claim settlements originate from unacceptable means such as investments in stocks of companies producing non-*halal* goods (alcohol or tobacco, for example) or services (gambling, for instance).

Finally, if the holder of an Islamic insurance policy decides to terminate a policy in a manner that is not provided for under terms of the contract, premiums are refundable along with any corresponding surrender value less administrative fees.

III. Research Hypothesis and Methodology

One of the complexities overarching the concept of Islamic insurance is anchored in the belief system pertaining to fundamental Islamic Law, while another is embedded in the role of profit within the *takaful* contract. Potential holders of a *takaful* contract may assume that any mention of profit renders it isomorphic with conventional insurance. This, of course, is not the correct perception. Misunderstanding this point alone may differentiate more liberal Muslims receptive to *takaful* from arch-conservatives who may shun any insurance altogether.

This leads to the expectation in this study that awareness of the availability of Islamic insurance is linked to perceptions or beliefs about Islamic fundamentals on religious and social goals. While statements of hypotheses are generally reserved for more rigorous theoretical development, for parsimonious reasons we defer to testing a formal hypothesis rather than a research question as follows:

H₁: Awareness of the takaful contract is associated with fundamental perceptions of Islamic principles.

Singapore is an ideal location to test such hypothesis given the multi-racial, multi-religious nature of the population, its rather ‘Westernized’ way of life, and its proximity to Muslim-majority Malaysia and Indonesia.

IV. Method

The data generated for this study is part of a larger research project where careful attention was given to generating a Muslim sample that matched Singaporean demographics very closely.² Specific to this study, the survey instrument contained a section with questions for Muslim respondents only. A comparison of the non-Muslim and Muslim sub-samples for the set of characteristics did not manifest any significant differences.³

Measures

For testing purposes, categorical data were obtained for two dimensions. One dimension involved ascertaining perceptions on the nature or properties of Islamic insurance. Thus, the first statement required a yes/no response to: (1) ‘The emphasis of Islamic insurance is on religious and social goals rather than profit-making.’ The second dimension focused on the

awareness of the *takaful* insurance concept, and required a yes/no response to: (2) ‘Are you familiar with Islamic insurance?’

The third question involved cross-classification and asked those who were *aware* of Islamic insurance to identify the most important factor when asked: (3) ‘You would consider buying Islamic insurance because of: (a) religious reasons; (b) better returns; (c) ability to meet financial needs better; or (d) transparency (i.e., to know how profits are being distributed)’.

The fourth question also involved cross-classification and asked respondents who were *unaware* of Islamic insurance the following: (4) ‘Profit returns from insurance are consistent with Muslim principles?’

V. Results

Based on data from the sub-sample of Muslim responses, a two dimensional contingency table was constructed (Table 1). The vertical dimension represents respondents’ awareness of the availability of Islamic insurance products – column 1 and column 2 represent awareness and non-awareness, respectively. The horizontal dimension deals with perceptions relating to Muslim beliefs about the nature of Islamic insurance. Perceptions in row 1 reflect the view that profit-making from insurance is compatible with Islamic principles whereas row 2 reflects perceptions that encompass religion and social goals but not profit-making. They are labelled liberal and conservative Islamic principles, respectively.

Table 1: Nature and awareness dimensions of Islamic insurance

		Existence of Islamic Insurance		
		Aware	Non-aware	
Nature of Islamic Insurance	Liberal Islamic Principles	Cell 1 25	Cell 2 1	26
	Conservative Islamic Principles	Cell 3 15	Cell 4 43	58
		40	44	84

The total frequency of 58 in row 2 was determined from responses to question (1). Likewise, the frequencies of 40 in column 1 and 44 in column 2 were determined from responses to question (2). The joint frequencies of 25 in cell 1 and 15 in cell 3 resulted from responses to question (3). Finally, the joint frequencies of 1 in cell 2 and 43 in cell 4 emerged from responses to question (4).

Hypothesis H_1 asserts a linkage between the nature of Islamic insurance and its awareness among the Muslim population. The frequencies displayed in Table 1 permit a chi-square test of independence between the two dimensions, the results of which suggest that the null hypothesis of independence must be rejected, thus providing support for hypothesis H_1 .⁴

Table 1 data further suggest that the link between those who are aware/unaware of Islamic insurance and the nature of Islamic insurance is not uniform. For example, column 2 shows that little awareness is associated with a large conservative element. Interestingly, the data in column 1 manifests an inverse relationship. Indeed, greater awareness (cell 1) appears to be related to a larger liberal perception of the nature of Islamic insurance. This suggests that in moving from unawareness to recognition there is a corresponding shift from conservative to liberal beliefs about the nature of Islamic insurance.

Respondents in cell 3 were aware of the *takaful* contract but held conservative perceptions about the nature of Islamic insurance. As an internal validity check, all Muslim respondents were asked if it was sinful to buy conventional insurance. Just over 14% of the sample indicated that it was, largely, it is assumed, because of the profit return concept. This number is not significantly different from the 15 in cell 3 in terms of the total sub-sample.

Evidence from Table 1 further suggests that only 47.6% (cell 1) of Muslim respondents were aware of its availability thus supporting the conjecture of the Finance Minister. More importantly, the results suggest that, of this percentage, only 62.5% are inclined to have liberal perceptions regarding the nature of Islamic insurance. This means that fewer than 30% of the respondents appear to be favourably disposed to the concept of the *takaful* contract.

In short, the results of this study show that Muslims who are supposedly the target recipient of Islamic insurance products remain largely unaware of the existence of these services. Moreover, the results show that Muslims with ‘conservative values’ are less aware of Islamic insurance in particular as compared with Muslims with ‘liberal values’.

This has immense implications for marketing this product. First, there is a large segment of the Muslim population that needs to be exposed to its existence. Second, the exact nature of the *takaful* contract requires careful dissemination to this potential audience. It appears from the results of this study that there is a significant association between not just becoming aware of Islamic insurance but the more fundamental issue of liberal versus conservative beliefs in the nature of the *takaful* contract.

Acknowledgements

An early version of this letter was presented to the 29th Annual Conference of The Eastern Economics Association. The authors are thankful for all the valuable comments received during the presentation.

Notes

¹ □ ‘Window of Opportunities for Islamic Financing’, *Karayawan*, Volume 3.

² □ In the interest of brevity, the details on the design, distribution and statistical analysis of the survey questionnaire are not included in this study. It suffices to state that every effort was taken to ensure that proper sampling and statistical methods were adhered to. Interested readers may contact the corresponding author for information.

³ Complete information regarding the descriptive/demographic characteristics of the sample for this study as well as for the larger study, which forms the basis of the current one, is available upon request.

⁴ $\chi^2 = 36.13$ ($p < 0.001$, d.f. = 1)

References

1. Billah, MM. 1996. Comment on Shaikh Al-Azhar's Fatwa against life insurance. *New Horizon*, 58: 3–6.
2. Maysami, RC and Kwon, WJ. 1999. An analysis of Islamic Takaful insurance – a cooperative insurance mechanism. *Journal of Insurance Regulation*, 18: 109–32.
3. Maysami, RC, Golriz, H and Hedayati, H. 1997. Pragmatic interest-free banking: metamorphosis of the Iranian financial system. *Journal of International Banking Law*, 12: 92–8.