

# Islamic Insurance vs. Conventional Insurance: A Comparative Case Study

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**Abstract:-** Insurance plays a very vital role in the modern world economic system. Because of its role in providing socio-economic prosperity and security to life and property it has been recognized as an essential service throughout the whole world. But one Islamic scholar declare the insurance as unislamic due to the elements of Gharer (uncertainty), Maisir (gambling) and Riba (interest) involved in the operation of insurance contract. According to a saying of the Holy prophet (SM), “which he told to a Bedouin Arab, who left his camel unchained to the will of Allah,” tie the camel and then leave it to the will of Allah.” In another hadith the prophet (SM) advised to help one another in furthering virtue and God consciousness and do not help another in furthering evil and enmity. In view of these hadiths it’s established that concept of insurance does not contradict with shariah. Though the sharia support the insurance but not conventional insurance.

## I. INTRODUCTION

Insurance exists in our world from olden times. The traders in the past too felt the necessity of insurance. In olden times they used to their trade, business, transport, education etc conventional insurance. And they would mutually arrange for safeguards against the risk of the sinking of their activities. Its methods were, all traders or man will join to form a fund or pool. They contribute little at a time and who draws the lot gets the full amounts. This was a good example of savings, when even a new or trader would suffer an accident, then the unfortunate man or trader would be recompensed by this fund so that he could recoup his loss and find his bearings against and establish his business. This is the old methods of insurance. During the last two decades the new concepts of Islamic insurance with the name of taka full has become known and is progressing in different countries of the world including Islamic and Non Islamic countries. The growth of Islamic Insurance (Takaful) companies has become a threat for the conventional Insurance. In order to find out the real threats a research study has been carried out which revolves around the concept of Insurance and how it’s the principles of Shariah. This study is regarding Islamic Insurance as an alternative of conventional insurance and its development in Muslim and Non-Muslim countries as well.

Uncertainty is one of the fundamental facts of life. Nobody or no firm exactly knows that the future holds and history provides numerous example of how a man kind has sought to remove or reduce the uncertainties of life. Insurance provides economic securities to mankind against loss of the life or material caused through adverse behavior of nature.

## II. OBJECTIVE OF THE STUDY

The main objective of the study is to know the Islamic insurance and compare with conventional insurance and others objective are\_

- To draw the comparative feature of conventional and Islamic insurance.
- To examine the cause of present situation of both Islamic and conventional insurance.
- To know historical development of both conventional and Islamic insurance.

## III. METHODOLOGY OF THE STUDY

In the background of the study, the conceptual foundation was taken as the core of the same. In order to present the fact in a logical format, the relevant materials and supporting information were collected mainly through desk study. The desk study covered text books, research articles, periodicals along with various published and unpublished research product on the subject. Moreover primary data and information were collected from staff personnel’s, insurance officials, and insurance customers of Islamic insurance business in Bangladesh.

The data and information, thus collected, were processed manually and presented by a descriptive model. The data were analyzed critically in order to make the study more informative and useful to the readers.

## IV. CONVENTIONAL AND ISLAMIC INSURANCE DEFINED

An idea about the concept of conventional insurance is one of the essential pre-condition required to develop one’s idea about the insurance in Islamic lines.

Insurance is the pre-action against probable loss. Insurance is defined as co-operative device to spread the loss caused by a particular risk over a number of persons who are exposed to it and who agree to ensure them solves against that risk. Risk is the uncertainty of a financial loss. Every risk involves lose of one or other kind. The function of insurance is to spread the loss over large number of persons who are agreed to co-operate each other at the time of loss.

Tomas as author’s defining as “Insurance is a provision, which the prudent man makes against fortuitous or inevitable contingencies, loss or misfortune”.

Insurance<sup>2</sup> is risk transfer mechanism the individual or the business enterprise can shift some of the uncertainties of life on the shoulder of the other. All the people will desire to live a cleaner, healthier, comfortable and easy life. To meet this requirement different enterprises produce and provide goods and services. They make innovation and invention, which take great risk. Large responsibility falls on the shoulder of innovators and inventors. A small error or lapse may cause numerous side effects and cause death or disability. These types of risks highlight the importance of insurance. If there had not been insurance at the back of all innovators the world would have never progressed.

In peace the insurance provides protection to trade and industry, which ultimately contributes towards human progress. Thus insurance is the most lending force contributing towards economic, social and technological progress of man.

Ahmad<sup>1</sup> cites various authors as defining insurance as, I) a co-operative form of distributing a certain risk over a group of persons who are exposed to it, II) a contract where by one party agrees in indemnity the other party against the loss which may arise or to pay a certain sum of money on the happening of a certain event in return of compensation called premium, III) the guarantee by one to consider against accidental loss and, IV) a contract whereby, for a consideration, the insurer binds himself to compensate the insured if the latter shall suffer a specific loss.

Again, Manes<sup>3</sup> and Al-din described insurance as a common pooling to alleviate the burden of the individual lest it should be ruinous to him. The simplest and most general conception of insurance is a provision made by a group, each singly in danger of some loss, the incidence of which cannot be foreseen, that when such loss shall occur to any of them it shall be distributed over the whole group, and in finality, defined the same as mutual coverage of accidental loss by group of persons subject to a common danger. Sen and Mitra<sup>8</sup> also upheld the same view with respect to concept of insurance as fostered by Manes and Al-din.

A perusal of the existing literature reveals that the concept of conventional insurance amply justifies its existence as a social mechanism aimed at as a safeguard against loss incurred by individuals to be borne by many collectively.

**Islamic Insurance Defined:** The Holy Quran as a rules sets certain bounds in every department of life within which the affairs relating to that department of life maybe ordered, over stepping of these bounds is forbidden, but within their limits the Muslim society is free to enact any rules which may be required to meet exigencies of a given environment of history. On economic front, Islam has set up certain principles and bound which is forbidden to transgress. Islamic insurance is on of them.

“Islamic Insurance concept which is grounded in Islamic muamalat(banking transaction) observing the rules and regulations of Islamic law. These fundamentals are based on the saying of Islamic prophet Muhammad (S.M) and it’s based on Quran and Hadiths”.

In so far as the point of economic security in Islam is concerned renowned Islamic scholars provide that Allah (S.W.T) as the only creator of universe is also the provider and provisioner of all creation including human beings, hath put forward a social system i.e. expected to remain responsible for the provision of mankind and all other creations and Muhammad (SM) as the vicegerent of Allah (S.W.T) upheld the message of consolation as given by almighty in matters of guarantee and security of livelihood and practically established a state a system that has discharged the entire responsibility in the regard<sup>9</sup>.

In this context, the Holy Quran has repeatedly mentioned in many of its verse and the prophet of Allah has times and again echoed the message of safety and security of livelihood and established the same as a reality though instituting a socio political system. Afterwards rightly guided caliphate upheld and continued the tradition concerned as a practice of reality for many years.

Again, community and society grow and this community feeling is a foundation of civilization. The characteristics of this society bound life and mutual feeling and earnestness have been repeatedly pronounced in the Holy Quran and declarations of the prophet (S.M).

Further, one of the leading Islamic Jurisprudents Imam Abu Hanifa (RA) has termed these people united within community bonds as Ahlaldewan and stressed need for their mutual assistance and co-operation. The case of insurance carried on, on Islamic lines wholly corresponds with the sense as mentioned above. Therefore, it is rightly asserted that the type of insurance carried on is an interest free, gambling free, uncertainty free environment which aims at social security and community welfare along with due emphasis over personal securities of human beings may be termed as Islamic insurance.

## V. THE CONCEPT OF INSURANCE IN ISLAM:

Islam aims at establishing a peaceful society. Peace in the society can be ensured only when there is a guarantee of rijk(Subsistence) for all the individuals constituting of society, since the absence of such a guarantee every one will suffer from worries anxieties. Allah the Almighty while creating the universe was fully aware of the need for such a guarantee as would be evident from the following provision of Holy Quran and Hadith .[ Sura-Hud 6, Sura-Al Bakara-29,201, Sura Ibrahim-32,34, Sura –Al-Hijr-20,22,Sura-Al-Zokhroaf 32, Sura Al-Hajj- 65, Sura Al-Isra-66,Sura Al-Mominun,-18,22,Sura Towaba -52, Sura Al –Kasas-77.]

- As the only creator of the whole universe Allah the Almighty has arranged for necessary livelihood of all His creations and has given proclamation for full security ensuring the provision of rijk for each of them.
- For this Allah the Almighty has designed the laws of nature accordingly and has endowed His creation with all the necessary wisdom and other qualities which would enable them to get the risk through their perseverance and effort.
- Allah the Almighty has also prescribed in His system the necessary outlines of the society and state which would be fully responsible for arranging rijk to His Creation.
- Hazard Mohammad (SM) as the last prophet of the Almighty Allah conveyed this message to the human race and also took steps in implementing those for their guidance.
- The arrangement of Almighty is such that in His system there will not be a single soul deprived of this basic rijk.

## VI. MAIN FEATURE OF ISLAMIC INSURANCE:

Before making comparison between conventional insurance and Islamic insurance, it is essential to know the basic feature of Islamic insurance. The analysis of the existing literature in the subject reveals the following main feature of Islamic insurance.

- Islamic insurance based on interest free, gambling free, uncertainty free and it's based on Islamic shariah.
- The insurance policy holder should have the right to participate in the surplus profit of the mudarabah fund of the company.
- The policy holders will be liable to contribute additional amount if the initial subscription are not sufficient to meet all the losses of the company.
- The company should maintain two separate and distinct amounts one knows as the policy holder's account and the other as the share holder's account.
- The company should invest its fund in those sources only which are permissible by Islam and should not indulge in the proactive of Riba in any form.
- A zakat fund should be created by way of charging 2.5% annually on the share capital, reserves and profit of the company.
- There should be a "shariah supervisory board" which will be responsible for supervising the day to day function of the company in the light of the shariah.

## VII. HISTORY AND ORIGIN OF INSURANCE:

Ashamed<sup>2</sup>, opines in this context that the history of insurance is obscure and unwritten. Some trace it back to the Rhodesian sea law, formulated approximately in 600 B.C. according to which it is claimed that owners of ships and cargoes used to share the losses sustained in sea-voyage on a joint basis. According to others, in imperial Rome, there existed collegial of artisans as early as 136 A.B. which used to pay the surviving department of their members a sum of money to meet the funeral expenses in

return of an original membership fee and monthly installment of premiums.

As a profit making business, the institution of insurance is not very old. Its origin as such can be traced to development Italian marine insurance trade which began 14<sup>th</sup> century, a court in burgess gave judgment in an insurance matter early as 1377 A.D. the episode of insurance as a profit making institution can be divided into three periods i.e first period: 14<sup>th</sup> century-17<sup>th</sup> century, second period-18<sup>th</sup> century-1<sup>st</sup> half of 19<sup>th</sup> century, third period: 2<sup>nd</sup> half of 19<sup>th</sup> century to date. Historically speaking the oldest branch of insurance is marine, then fire and finally by social insurance. Organizing insurance along the Islamic lines is also a significant development of the current century. Against this background the objectives of Islamic insurance may be considered worthwhile. A Hanafi lawyer Ibu Abidin (1784-1936) is the first Islamic scholar to come up with the meaning, concept and legal basis of an Islamic insurance contract (Klingmuller 1969). Until 1963, there was no specific legislation in Malaysia regulating the insurance practice. The very first Islamic insurance company was established in 1979 (Takaful) of Sudan and Bangladesh in 1999 (Life Takaful).

## VIII. COMPARISON BETWEEN CONVENTIONAL INSURANCE AND ISLAMIC INSURANCE:

Arising from the comprehensive and detailed studies made by Muslim jurists on the operation of the conventional insurance, the generally accepted view of the Muslim jurists is that the operation of the conventional insurance does not in its present form conform to the rules and regulations of the shariah.

Therefore, comparative discussion between the conventional insurance and Islamic insurance may be made in the following paragraph:

### ➤ *Natures:*

Conventional insurance is based on profit motive and aims to maximize return to shareholders. The business of insurance is, in essence "owned" by shareholders of the insurance company. Islamic insurance on the other hand is based on the motives of the community welfare and protection. The business of insurance itself is non-profit. The insurer is now called the takaful operation who received a fair compensation, either through a share in returns on investment of funds or through agency fees. The business of insurance is in essence "owned" by policy holder and Operator Company acts as the agent manager.

### ➤ *Permissibility of valued policy:*

Under the conventional insurance valued policy are considered as contract of indemnity. Generally valued policy are issued only on articles of fairly stable value and it is said that in a valued policy the measurement of indemnity is decided at the inception of the contract, the insurer agree to pay the value agreed at the inception of the contract, in case of total loss, without the usual allowance for depreciation or appreciation at the time of loss. In case

of partial loss the insured value is the limit of the insurer. Thus if the actual value falls below the sum insured, the policy holder will received more than a strict indemnity or vice-versa. This is not permissible in Islam, However, even when an unvalued policy is issued and if the value of insured property rise and then there is a loss, the sum insured is the limit of liability of the insurer. This is also not permissible in Islam.

Insurance in Islam ought to be practiced on the true principles of indemnification and insurance under Islamic system should be issued after proper valuation. Periodical valuation must be made to off-set the effect of any appreciation or depreciation in the value of property, the premiums have to be adjusted as per aggregate risk involved throughout the policy period.

➤ *Innocent misrepresentation of material facts:*

Under conventional insurance, it is generally held that even on Innocent misrepresentation of material facts in the insurance contract is no defense to the insured, if the insurer intends to avoid the contract. It is said that the insured should be liable for his carelessness. But this is not in case of Islamic insurance since insurance under Islamic principles is run for the mutual benefits of all the members of insured group and policy holders. It is left that an Islamic insurance company should not avoid insurance contract totally if they are arise and Innocent misrepresentation of material facts. However for the sake of good orders there may be provisions for penalty on the claimed amount.

➤ *Provision of sharing profit and losses of the company:*

Although the conventional life insurance system works through a system of resource pooling, the insured does not have the right to enter any mutual agreement with the insurance company for sharing its profit and loss. The idea of mutual help and cooperation is absent in conventional insurance. Under this system the insured cannot claim profit, and in case of the losses of the company the insured does not bear the losses. This is not permissible in Islam. The real objectives of Islamic system of insurance are in fact not primarily the losses protection but sharing of resources. The member under the Islamic insurance scheme is in real sense the investors of a saving plan, where by the member agree to share resources for mutual protection against certain period of life.

➤ *Scrutiny of the company account:*

Under conventional insurance, the policy holders have no right to scrutinize the account of the companies. In case of other insurance, companies the question of right to scrutinize the account of the companies does not arise at all. But in case of Islamic insurance of all types policy holders must have the right to scrutinize the account of the company.

➤ *Investment of the fund of the company:*

Under conventional life insurance the fund of the companies is to be invested compulsorily in govt. securities, to the extent of 60% of the fund and the rest in any approved investment. Since govt. securities are interest

bearing hence, it is not permissible by shariah. In case of other insurance under conventional system, the fund of the companies are also invested in interest bearing sources like investment in company share and securities govt. securities etc.

Therefore conventional insurance involves riba, so far as investment of companies fund is concerned. But in Islamic insurance the investment of companies funds in interest free sources are permissible by shariah. To this end shariah profit based investment is introduced.

➤ *Provision for maintaining two separate accounts:*

The insurance act<sup>7</sup> which is followed in Bangladesh does not have any provision for maintaining two separate accounts, one for policy holders and other for share holders. This is against the provision of Islamic insurance where maintenance of two separate and distinct accounts is must. Under Islamic insurance the policy holder's account is credited with all contribution made by the policy holder and their share of profit on investment of funds. The policy holder accounts are debited with their proportion of service charge and claim.

➤ *Main motives of the insurance business:*

Just as in case of the insurer, the insured or policy holders may or may not be governed by profit motive. For instance, in conventional insurance, the insured or policy holder may decide between original costs or replacement cost as the basis of valuation and claim accordingly whether or not they chose to rebuild property. In Islamic insurance, however the insured may not profit from insurance and are entitled compensation only for repair or rebuild or replacement.

➤ *Roles in the insurance company success and progress:*

Under conventional insurance, since there is no relationship between the insured, they have no interest in the company's success and progress as they own nothing in the company. But under Islamic insurance, in case of co-operative insurance, Group member represent the interest of the member as he is the insurer and insured. Therefore he does his best for the company success and progress.

➤ *Creation of Zakat fund and formation of shariah supervisory board:*

Under conventional insurance there is no provision for creation of zakat fund. Moreover the management and the supervision of the company day to day function are vested on the controlling authority of the insurance company and there is not a shariah board.

But under Islamic insurance, there is a provision for creation of a zakat fund by way of charging 2.5% annually on zakatable funds of the company. Mhammed (SM) says – "You should pay zakat of your wealth (Tirmizi). The day to day function of the company is supervised by a shariah board which performs it functions in the light of the shariah.

## IX. CONCLUSION

The purpose of this paper has been shown the origin, concept and contribution of Islam in the development of Islamic insurance. From the above discussion it may be conclude that although from the view point of principle and concept there is no conflict between the conventional insurance and Islamic insurance, but from operational view point, there are many conflicts between these two types of insurance regarding ten major operational aspects as discussed above. An Islamic insurance company should transact on a co-operative basis in accordance with and subject to Islamic shariah (Quran and hadiths) otherwise, the insurance should be conventional.

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