



ARTÍCULOS

UTOPIA Y PRAXIS LATINOAMERICANA. AÑO: 25, n° EXTRA 2, 2020, pp. 50-55
REVISTA INTERNACIONAL DE FILOSOFÍA Y TEORÍA SOCIAL
CESA-FCES-UNIVERSIDAD DEL ZULIA. MARACAIBO-VENEZUELA.
ISSN 1316-5216 / ISSN-e: 2477-9555

Identification of non-sharia compliant activity in conventional insurance

Identificación de actividades que no cumplen con la sharia en el seguro convencional

A Shofawati

<https://orcid.org/0000-0002-9648-1077>

atina-o@feb.unair.ac.id

University of Airlangga, Surabaya, Indonesia.

Este trabajo está depositado en Zenodo:

DOI: <http://doi.org/10.5281/zenodo.3808701>

ABSTRACT

Insurance is a commercial institution that has the function of protecting individuals, organizations and companies against risk. This document is intended to identify non-shariah activities in specific insurance. One of the disadvantages of conventional insurance is the existence of an activity that does not comply with sharia such as Reba, Maysir and Gharar. Islamic insurance has some solutions to minimize activity that does not comply with the sharia of conventional insurance.

Keywords: Conventional insurance, islamic insurance, non-sharia, compliant activity.

RESUMEN

El seguro es una institución comercial que tiene la función de proteger a las personas, organizaciones y empresas contra el riesgo. Este documento tiene el propósito de identificar actividades que no cumplan con la sharia en los seguros convencionales. Una de las desventajas del seguro convencional es la existencia de una actividad que no cumpla con la sharia como Reba, Maysir y Gharar. El seguro islámico tiene algunas soluciones para minimizar la actividad que no cumple con la sharia del seguro convencional.

Palabras clave: Seguros convencionales, seguros islámicos, actividades que no cumplen con la sharia.

Recibido: 02-03-2020 • Aceptado: 10-04-2020



INTRODUCTION

Islamic Insurance is one instrument of Islamic finance which has the purpose to protect the society from the damage, accident, losses, sickness and another uncertainty condition. Islamic Insurance was regulated by Otoritas Jasa Keuangan and was classified as Industri Keuangan Non-Bank (IKNB). The market share of Islamic insurance is little compared with the market share of conventional insurance. Market education and promotion must do to increase the market share of Islamic insurance because of the ability of insurance to cover the risk is determined by the volume of market share. The insurance industry follows the law of large number so the availability of market share is essential to cover the risk (Mustafa & Ab Rahman: 2018).

The main function of insurance is to reduce risk. For the insurer, by combining many individual loss exposures, he can reduce it by spreading the cost of the unexpected losses between the participants. The key to this function is the law of large numbers, which implies that increasing the number of loss exposures decreases the risk of the total outcome. As for the insured, he can reduce risk by transferring the risk to the insurer who promises to reimburse him when a loss occurs (Hussain & Pasha: 2011).

Islamic insurance is different from conventional insurance. Islamic insurance emphasizes risk-sharing but conventional insurance emphasizes the risk transfer. This basic principle has an impact on the different operation mechanism between Islamic insurance and conventional insurance. Conventional insurance has an important role to protect the society from risk but the mechanism of conventional insurance is still conducting some elements which are prohibited in Islamic insurance which cover Reba, Maysir, and Gharar. Islamic insurance is also known as *takaful* and taken, so the three terminologies often used substitutive refers to Islamic insurance.

The word *Takaful* is derived from the Arabic verb 'Kafala', which means to guarantee, looking after, to help and to take care of one's needs. *Takaful* is a system of Islamic insurance based on the principles of 'ta'awun' (mutual assistance) and 'Tabarru'(voluntary contribution)². Islamic insurance or *takaful* has a mechanism to mitigate the risk according to sharia compliance. Islamic insurance also gives the solution to minimize the mechanism in conventional insurance which is prohibited in Islamic insurance like Gharar, Reba and Maysir (Hassan: 2019).

It is a natural phenomenon in any society that everybody is exposed to all sorts of risks in their daily life. It may be expected and some are unexpected. These risks may occur to one's life, properties or even business ventures. Often, these risks affect the lives of many individuals in society which sometimes so devastating and shattering. The effect is that they may leave these unfortunate people vulnerable and helpless. Islam promotes the act of taking precautionary measures or 'ikhtiar' against any risks. For instance, in the holy Quran, it is clearly described how Prophet Youssef (Allaihi Salam) filled the grain silos from the surplus of seven years of a good harvest as a protection to ensure the availability of continuous food supply during the seven years of drought. This is a clear indication that one has to strive hard to avoid being inflicted by any ill-luck and at the same time be fully prepared. The primary objective of insurance is to uphold, among the parties involved, shared-responsibilities based on mutual co-operation in protecting an individual against unexpected risks (Rahman et al.: 2019).

Though there are many types of risk prevalent in the society, an insurance contract only deals with pure risk, which refers to those situations that can result only in a loss or in no change at all (neutral). The exposure to the loss of one's home by fire is an example of an exposure to pure risk. The house either burns or it does not burn. For a life policy, the risk involved in the occurrence of death or injury upon the insured. Both either happen or not. It is the opposite of speculative risk, which refers to the situation that can result in a gain, loss, or no change¹. However, for practical purposes, not all pure risks can be privately insured. There are ideally certain requirements of an insurable risk like a sufficiently large number of homogenous exposure units to make the losses reasonably predictable. While the loss produced by the risk must be definite or determinable, it also must be fortuitous or accidental and unintentional and should not be catastrophic (Uddin: 2015).

It has to be stressed that the creation of the *takaful* contract itself is very much in line with Islamic values.

These are, providing financial help against unexpected future loss, contributing to the reduction of poverty, as well as encouraging the development of cooperation and the spirit of brotherhood. It ultimately, cultivates solidarity, establishing a self-reliant society, and lastly, encouraging trade and commercial activity to flourish. Insurance or takaful is a mechanism to help the ummah solve some of the social-economic problems faced by many nations in this world. As narrated by Abu Hurayrah, the Prophet S.A.W. said, "Whoever removes a worldly grief from a Muslim, Allah will take away one of his grief"s in the hereafter, whoever alleviates the needy, Allah will alleviate from him in both the world and Hereafter. According to Hussain & Pasha (2011) insurance in Islam is essentially a concept of mutual help. Insurance business under the conventional system is based on uncertainty, which is prohibited in an Islamic society under Islamic principles. So there is a need to clear the difference between conventional insurance and Islamic insurance. By their nature, Takaful companies face additional risks as compared to conventional insurance. Conventional insurance companies invest a large amount in fixed income securities on their balance sheet to minimize the risks and the variability associated with the equity. But in Takaful under Sharia law, interest is forbidden, which rules out the investment in fixed income securities. Under the Takaful contract, every policyholder has the right to know how profits from different investments are divided among the participants but under the conventional system there is no hard and fast rule for profit distribution, it depends on company management. The discussions on whether conventional insurance is in line with the Sharia have manifold but the widely accepted view is that conventional insurance is contrasting to Takaful (Bocharov: 2019, pp. 321-328).

This study describes the identification of non-sharia compliant activity in conventional insurance and the solution of Islamic Insurance to minimize non-sharia compliant activity in conventional insurance. The research question in this study about what is the non-sharia compliant activity in conventional insurance and what is the solution of Islamic Insurance to minimize non-sharia compliant activity in conventional insurance.

METHODS

This paper uses qualitative descriptive method to identify the non-sharia compliant activity in conventional insurance and the solution from Islamic insurance to minimize the non-sharia compliant activity in conventional insurance which is based on the literature study from (Ahmad: 2003, pp. 61-80; Iqbal: 2005; Ma'sum: 2001; Matsawali et al: 2012; Hussain & Pasha: 2011, pp. 23-28; Uddin: 2015; Zinnatullina et al.: 2019, pp. 357-369).

RESULTS

In essence, Islam does not reject the concepts of insurance. Many Muslim jurists agree that insurance which is based on the concept of pooling of losses does not contradict with the Shari'ah. Compensation to an unfortunate member and group responsibility is not only accepted but encouraged in Islam. Although the models operation of Takaful must comply with the Shari'ah, the basic elements of a contract, as well as insurance principles (utmost good faith, proximate cause, indemnity, and insurable interest), also apply (Fahad: 2005) in (Matsawali et al.: 2012). According to Muhammad Nejatullah Siddiqi (Siddiqi: 1985) in (Matsawali et al.: 2012) there are three elements present in conventional insurance that do not conform to the requirements of the Shari'ah law:

i) Al-Gharar. This refers to 'unknown' or 'uncertain' factors in a conventional insurance contract. In conventional insurance, policyholders are not informed on how profits are distributed and in what the funds are invested in. In a Takaful operation, this is based on the Mudharabah concept, the distribution of profits to the operators and the participants are clearly outlined in the contract (Mustafa & Ab Rahman: 2018).

ii) Al-Maisir. This is the 'gambling' element and is said to derive from the 'Gharar' element. In conventional insurance, the policyholder stands to lose all the premiums paid if the risk does not occur. On the other hand,

he stands to get more should misfortune happen whilst paying a small amount premium. In Takaful, even though the risk does not occur, the participant is entitled to get back the contributions that he has paid. Should the risk occur, he will be paid from his premium fund plus the pool of funds from the 'donation' of other participants?

iii) Reba this refers to the interest factor present in the investment activities of conventional insurance companies. The policy loan in conventional life insurance is, in fact, a Reba based transaction. Islam prohibits any investment activities which are interest-based in alcoholic beverages and non-Halal products.

Analysis and discussion in this study cover the identification of non-sharia compliant activity in conventional insurance and then describe the mechanism and solution of Islamic Insurance (takaful) to minimize the non-sharia compliant activity in conventional insurance which is prohibited in Islamic Jurisprudence. According to (Uddin: 2015) prohibition of Reba, Gharar, and Maysir in financial transactions is the fundamental of Islamic finance which distinguishes it from conventional finance. These unique features of Islamic finance are going to be discussed from the Shari'ah, Quran and Sunnah, perspective; a brief literature review has been conducted to clarify these concepts, current practices and controversial issues in not only conventional but also Islamic finance industry. Adoption from (Uddin: 2015) this paper identifies the non-sharia compliant activity of conventional insurance as an instrument of conventional finance which covers Gharar, Maysir, and Reba. The operational mechanism of conventional insurance is still conducting an activity that reflects the Gharar, Maysir, and Reba.

Identification of Non-Sharia Compliant Activity in Conventional Insurance cover Reba, Gharar, and Maysir:

1) Reba

On Reba, the direct Quranic references are to be found in four surahs or chapters. These verses are an ascending scale that starts with a mere judgment of value, followed by an implicit prohibition, then a limited one and finally, a total and conclusive prohibition (Al-Rum, 30:39; Al-Nisa, 4:161; Ali-Imran, 3:130 and Al-Bakarah, 2:275-9). Reba arises with the loan: car loan, home loan, term loan or overdraft, hire purchase loan and a personal loan; Reba in savings and fixed deposit account; Reba in credit card.

2) Gharar

The Arabic word Gharar is a fairly broad concept that means deceit, risk, fraud, uncertainty or hazard that might lead to destruction or loss. Anything that the result is hidden or the risk is equally uncommon, whether it exists or not. Therefore, Gharar in Islam refers to any transaction of probable objects whose existence or description is not certain, due to lack of information and knowledge of the outcome of the contract or the nature and quality of the subject matter of it.

Gharar occurs in all sorts of transactions where the subject matter, the price or the two, are not determined and fixed in advance. Speculative activities in the capital market, derivatives instruments, and short-selling contracts are bright examples of Gharar in modern finance. Moreover, Gharar in practice relates potentially to issues such as pricing, delivery, quantity, and quality of assets that are transactional-based and would affect the degree or quality of consent of the parties to a contract.

In conventional insurance, the premium paid by policyholders and the indemnity provided by the insurer upon a claim is equally uncertain, thus making conventional insurance non-compliant from an Islamic legal perspective.

3) Maysir

Maysir means gambling. Islam has also categorically prohibited all forms of gambling. Maysir refers to the easy acquisition of wealth by chance, whether or not it deprives the other's right. For example, the uncertainty of the timing of benefits of a pure life insurance contract creates an element of Maysir. In brief, contracts involving pure speculation, conventional insurance and derivatives are examples of Maysir.

The solution of Islamic Insurance to minimize non-sharia compliant activity in conventional insurance. This paper emphasizes the solution to minimize Gharar, Maysir, and Reba.

In risk assessment (underwriting) and handling, Takaful does not allow what is called *Gharar* (i.e. uncertainty or speculation) and *Maysir* (i.e. gambling). In investment or fund management *Reba* (i.e. usury)

is also not allowed. These three Gharar, Maysir, and Reba are the areas that must be avoided by the Takaful operation, and where it differs with the conventional insurance.⁵ To avoid *Gharar*, there must be a complete clarify or full disclosure of any Takaful contract. Full disclosure is applicable on both sides, i.e.

DISCUSSION

On both the subject matter and terms of the contract (scope of cover, etc.). It is not allowable to enter into a Takaful contract if there is an unknown element on the subject matter and/or unknown exposure to the extent of the contract itself. As this ideal situation hardly exists, the Takaful contract then needs to be made in a way that there is no exchange of Gharar from one party to another (Ahmad: 2008) study issues of Gharar in insurance and conclude that conventional insurance does carry excessive Gharar. They argue that in conventional insurance subject matters exchange in the contract are between money and money which is a kind of buying and selling contract thus making the contract exposed to conditions or requirements of reasonable knowledge in the subject matters' quantum as well as the ability to deliver them. Moreover, the uncertainty comes in the form of pure risk which is implicated with fear of risk, for example, the death of the policyholder or the incident insured is not vague and is identified before the commencement of a policy in Uddin (Uddin: 2015).

Maysir (gambling) is regarded as the excessive side of the Gharar. Whilst the participants (insured) may have an insurable interest in the subject matter, if the risk transfer (risk-sharing in Takaful) contain any speculative element, then it is prohibited under the Takaful⁵. Reba (usury) is prohibited under the Sharia Law and a Takaful arrangement. To avoid Reba, Takaful treats participants 'Contribution to the risk-sharing scheme not as a premium in the way conventional insurance does. In Takaful terms, it is treated as being a contribution (Mushahamah) in the form of donation with a condition of compensation (Tabarru). Furthermore, the pool of funds secured from those participants ' contributions or donations, must be managed and invested following the shariah.

The solution of Islamic insurance to minimize the non-sharia compliant activity of conventional insurance which covers Gharar, Maysir and Reba generally is conducting business activity based on Islamic Jurisprudence and also conduct management properly (Rahman et al.: 2019; Nooradi et al.: 2017, pp. 71-75). Especially, solution which minimizes Gharar there must be a complete clarify or full disclosure of any Takaful contract, solution which minimizes Maysir is by avoiding Gharar because Maysir (gambling) is regarded as the excessive side of the Gharar, while the solution which minimizes Reba, Takaful treats participants 'Contribution to the risk-sharing scheme, not as a premium in the way conventional insurance does. The implication of this paper advises on conventional insurance opens the branch office which operates the sharia unit of conventional insurance to conduct Islamic insurance operational according to sharia compliance.

CONCLUSION

Identification of Non-sharia compliant activity in conventional insurance cover Gharar, Maysir, and Reba. The solution mitigates and minimizes the non-sharia compliant activity in conventional insurance which covers Gharar, Maysir Dan Reba generally by conducting business based on Islamic Jurisprudence and increase management properly. Solution which minimizes Gharar there must be a complete clarify or full disclosure of any Takaful contract, solution which minimizes Maysir is by avoiding Gharar because Maysir (gambling) is regarded as the excessive side of the Gharar, while the solution which minimizes Reba, Takaful treats participants 'Contribution to the risk-sharing scheme, not as a premium in the way conventional insurance does.

BIBLIOGRAPHY

- AHMAD, WMW (2003). "Some issues of Gharar (uncertainty) in insurance". *Jurnal Syariah*, 11(1), pp. 61-80.
- AHMAD, WMW (2008). "Some Issues of Gharar (Uncertainty) in Insurance". *Essential Readings in Islamic Finance*.
- BOCHAROV, SG (2019). "Balaklava: Introduction to the Historical Topography of 1475-1774 Ottoman Town on the Crimean Peninsula", *Stratum Plus*, 6, pp. 321-328.
- FAHAD, S (2005). "Takaful – Measuring Public Awareness of the Takaful Insurance in Kuwait, Servqual Model Applied to the First Takaful Company". *Maastricht School of Management (MSM), Maastricht. The Netherlands*.
- HASSAN, HA (2019). "Takaful models: origin, progression, and future". *Journal of Islamic Marketing*.
- HUSSAIN, MM & PASHA, AT (2011). "Conceptual and operational differences between general takaful and conventional insurance". *Australian Journal of Business and Management Research*, 1(8), pp. 23-28.
- IQBAL, M (2005). *General Takaful Practice: Technical Approach to Eliminate Gharar (uncertainty), Maisir (gambling), and Riba'(usury)*. Gema Insani.
- MA'SUM, BM (2001). *Principles and Practices of Takaful and Insurance Compared*. International Islamic University. Malaysia-2001.
- MATSAWALI, MS, ABDULLAH, MF, YEO, CP, ABIDIN, SY, ZAINI, MM, ALI, HM ... & YAACOB, H (2012). "A study on takaful and conventional insurance preferences: The case of Brunei". *International Journal of Business and Social Science*, 3(22).
- MUSTAFA, A & AB RAHMAN, A (2018). "The Islamic Perspective on the Underwriting of Health Takaful Products: A Study of Selected Takaful Operators in Malaysia". *New Developments in Islamic Economics: Examples from Southeast Asia*, 135.
- NOORADI, M, BAGHERI NIA, H & OULIAEY, A (2017). "Are the manager's bases of power related to job satisfaction?" *UCT Journal of management and Accounting Studies*, 5(3), pp. 71-75.
- RAHMAN, NA, OSMAN, ZA, ANI, NS & AHMAD, Z (2019). "Religious and Socioeconomic Implications of Islamic Insurance: A". *International Journal of Financial Research*, 10(5).
- SIDDIQI, MN (1985). *Insurance is an Islamic Economy*. Nairobi, Kenya: Islamic Foundation.
- UDDIN, MA (2015). *Principles of Islamic finance: Prohibition of riba, gharar, and maysir*.
- ZINNATULLINA, Z., DAVLETBAEVA, D., & MUKHAMETSHINA, R. (2019). "Literature and Cinema: Ways of Interaction in the 21ST Century". *Journal of Social Studies Education Research*, 10(4), pp. 357-369.

BIODATA

A Shofawati: Is a lecturer in the Faculty of Economics and Business, Universities Airlangga, Indonesia. She has current research interest in: Good Corporate Governance, Corporate Social Responsibility, Islamic Finance, Islamic Banking, Islamic Capital Market and Islamic Investment, Risk Management, Islamic Insurance, Digital Finance and Financial Technology, Islamic Microfinance, Islamic Social Finance, and Supply Chain Management.