



## ANALYSIS OF CONVENTIONAL INSURANCE UNDER ISLAMIC TEACHINGS AND IMPLEMENTATION OF TAKAFUL IN PAKISTAN

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### **Abstract**

*Pakistan is an Islamic country which has made a commitment through its Constitution that no law can go against the spirit of Islam. It is with this spirit that laws of Insurance should also be viewed. The chief legislation of Pakistan in relation to insurance is Insurance Ordinance 2000. There is a need to conceive Islamic alternative to insurance which is called takaful. Conventional insurance is viewed as form of contract where risk is shifted from the person who has paid consideration known as premium to another party. The person paying the premium is the policy holder or the insured while the person who takes on the risk is the policy provider or the insurer. The conventional concept of insurance is riddled with problems of riba (Interest), maysar (gambling), and gharrar (uncertainty). The Islamic concept of takaful is on the other hand conceived as maintenance of fund known as tabaru fund by collective contributions of indemnified members. In this concept, there is no one who takes risk but rather all people agree to be liable to the person who has suffered a misfortune and this is based on the concept of aqilah which existed in Arab tribes at the time of the Prophet ﷺ. The tabaru fund is also invested as forming part of mudarabah investment and any surplus in the fund is distributed accordingly. For the implementation of takaful form of insurance in Pakistan there is a need to overcome certain obstacles such as lack of education and willingness of people along with problems of corruption and transparency in the country.*

**Keywords:** *Islamic Law, Conventional Insurance, Islamic Insurance, Takaful, Pakistan*

### **Introduction**

Insurance has become a necessity of life, people unable to live lives in the present world without resorting to insurance. For this aspect it needs to be studied. There are however multiple problems of insurance that exist which make it a prohibited activity in Islamic Law. There has been development of the concept of insurance in the Islamic literature. In Pakistan, insurance is regulated by Insurance Ordinance 2000. The concept of insurance in Islam is called takaful which comes from the word kafala which means taking care of each other. This tries to cure many of the defects in the conventional form of insurance (Alshammari, Syed Jaafar Alhabshi, & Saiti, 2018).

Conventional insurance is criticized due to riba, gharar, and gambling. Judging takaful on the criteria of these prohibitions, it is clear that riba resulting from investment of insurance funds through interest-based channel is completely eliminated. There is an additional improvement as takaful funds are employed into halal activities only while insurance investments are partly channeled into haram industries like casinos and liquor businesses (Nahar, 2015).

Pakistan should implement Islamic form of takaful which should allow for maintenance of takaful mainly through the Government but private forms should also be allowed. There should be adaptation of Islamic law in general and all forms of laws that exist against Islam should be abolished. There needs to be transparency against corruption of the government and investment policies of takaful. There needs to educate people at the primary level because Muslims can only be expected to spend their life in accordance with Islam when they are properly taught about Islam. Social media is an easily accessible alternative for education and awareness in the short term (Hamid & Nadeem, 2002).

This research paper attempts to compare both these forms of insurances and suggest why takaful is suitable for Pakistan since it is an Islamic country and faces many problems of coverage which takaful can solve.

This research critically analyze conventional insurance in the light of Islamic teachings, try to determine level of implementation of Islamic principles in Takaful rules of Pakistan, analyze awareness regarding

conventional insurance and Takaful in Pakistani society, and recommend changes for regulations of Insurance laws and Takaful rules in Pakistan.

The research methodology used to conduct this particular research work is doctrinal, hence the research method is analytical as both primary and secondary sources are to be relied upon in this research such as primary sources are statutes, case laws and journals and secondary sources are different commentaries about insurance.

### **An Overview of Conventional Insurance**

Insurance is an important aspect of the society which is suitable for governmental and legal control. It is the transfer of risk from one party to another for a premium. It has effects on policy formulation and economy of a country. The traditional perception of insurance has changed over the ages and today it is a contract of greater complexity and importance. Insurance is still developing in multiple directions due to new and evolving technological advancements (Satyal, 2010).

The concept of traditional insurance has changed to a more comprehensive concept. The traditional concept of insurance is that, it is a contract to shift the risk of some misfortune over to another entity. In insurance, you pay an amount of money which is called the premium in consideration of economic loss shifts a greater future loss which may or may not occur to some different entity which is usually the insurance agency (Dahnoun & Alqudwa, 2018).

There has been a shift from a laissez-faire society, a type of society which believes that the government should have a minimum role in the society which includes only providing protection and maintaining peace, to a welfare society. Today the government takes notice of all the different types of issues that might inflict individuals in a harsh manner and which they would without government assistance be unable to resist. This is stated in the quote "Liberty of wolves is death for lambs". Insurance today is considered a matter of state policy and protection of citizens. Today insurance is mandatory in multiple areas. This is a sort of economic protection for individuals and by extension for the entire country. Since this is a matter of importance for the country as a whole it follows that the country has set in place laws which regulate insurance. This is a type of safeguard at the one hand for the insurers who may suffer fraud and on the

other hand insured who may be forced to accept unfavorable conditions because of imbalance of power etc (Jerry & Richmond, 2012).

The concept of insurance is based on law of probability called the law of large numbers, that is, when a few coins flipped, it is harder to guess how many are heads and how many are tails but when a large number of coins are flipped their distribution is almost fifty percent. In the same way a large number of insurances are issued, it is easier to consider how much loss will be caused. There can be no absolute kind of protection against a broken leg. This simple example can illustrate that the risk protection is only a type of economic incentive that will compensate for injury. (Tinungki, 2018).

A monetary compensation in cases where a substantial loss which would leave a person dependent for his life is a good safeguard. The concept of compensation in the form of money is the older concept and was only developed into other forms of compensation in the western world after its introduction by equity law. This was seen as unjust to give compensation of money in certain cases as different types of remedies have developed over time (Nzyoka & Orwa, 2016).

In any society, the risk of loss is placed on one of three persons. The first being the person who has sustained a loss is given the responsibility of making up for that loss. The second is the person who has caused the loss. If a person has caused a loss, let us say through an accident, then that person is legally liable to compensate the other person. The third responsibility is placed on the person who is the most logical recipient for the responsibility. In one case, a car company refused to take responsibility of an accident caused by car's faulty parts stating that they will only pay for the car and not medical expenses. They refused it on the basis of their terms and conditions to which the victim had agreed. The responsibility is still on policy considerations placed on the car company. In the second of the above cases, insurance can compensate for the people who are involved in an accident and in that way it can shift the responsibility to the insurance providers which will handle a certain type of responsibility for their clients (Ismail, 2013).

Not all insurances are created equal. Some insurances are issued for specific types of perils while other insurances are more comprehensive. There is no necessity of this to be the case, this is how insurance has historically developed. Insurance is a business and this business flourished in the form of multiple different insurances that cover different varieties of issues and

are complicated. It is always the duty of the insured to prove to the insurer that a certain type of damage has taken place (Grize, 2015).

In Life Insurance, legal heirs can claim a monetary benefit on the death of the person insured. There are different payment plans some for entire life while other for a portion till a certain event. Some insurances cover certain types of dangerous professions. These insurances are an integral part of any society because they allow for a person to leave something behind for his family if they are dependent upon him (Kunreuther, Pauly, & McMorro, 2013).

General insurance is in distinction to life-insurance which is an insurance of all other assets which includes injuries as well. General insurance like any other insurance comes in a variety of shapes. These range from minor coverage to comprehensive insurances of every economic aspect. A general insurance plan runs to provide a person sort of safety net which allows him to use items and invest his money in a more secure way. This promotes economic activity in multiple directions. The effects of general insurance are even greater for those items which have a greater monetary value or an investment of phenomenal proportions (Huynh, Bruhn, & Browne, 2013).

With the advancement of technology, insurance is likely to change its shape. There are many different types of digital assets that are gaining in value. There is development of crypto market and the art industry in the Non Fungible Token section. There need to be a redevelopment of theories of insurance to accommodate these novel changes. The role of technology in shaping the future of insurance law cannot be overestimated (Valeonti and Others, 2021).

### **An Overview of Islamic Insurance (Takaful)**

Islamic Insurance called Takaful comes from the Arabic word kafala which means looking after each other. The concept is that a pool of donations is created from which people are helped and that the money is distributed based on wasiyah if the donator dies. Takaful, being the Islamic replacement for insurance, follows some general principles of insurance. It is of both type life insurance and general insurance. There are slightly different models of Takaful. In takaful, the premium is called tabaru. This tabaru is invested in the form of mudaraba and if it generates a surplus in the tabaru funds, it is shared between the company and all the participants. The indemnity is paid out of the tabaru funds. There is a difference of opinion

whether all participants or just those who have not received indemnity should be paid out of the surplus of investment (Bhatty & Nisar, 2016).

Insurance has been a debated concept in Islam. There are many who oppose it and many who support it. Those who support it support different versions of takaful – the Islamic substitute for insurance. There are many arguments which have been given in opposition of insurance and these arguments are not wholly met. There are arguments of necessity which are made in favor of insurance as without it there might be great economic and international cooperation loss. There is a need to describe what takaful is before it can be discussed in the context of Pakistan and implementation in Pakistan (Zaman, 2010).

The concept of Insurance in Islam and its legal standing discussed first by Ibn Abidin in the 19<sup>th</sup> century. It is after this that the discussion of insurance reached central stage. It is highly debated and multiple opinion varying on all the different aspects of insurance its adoption and legitimacy. There is a consensus to some extent on the concept of Islamic insurance under the name of takaful and at the end of the 20<sup>th</sup> century thus multiple takaful companies are established (Hussain & Pasha, 2011).

There has never been unanimous agreement among the scholars on the matter of insurance. There have been multiple attempts considering a vast amount of literature yet the questions are remained unanswered. The contract of insurance has not been among the traditional forms of contract of Islam and fatwas in support of insurance found mostly in 20<sup>th</sup> century. Some scholars state that the contract of insurance is allowed as long as it is pure from interest, gambling and indeterminacy. It is in fact not knowing of what constitutes the presence of interest, gambling and indeterminacy or difference of opinion thereto led to divide among the scholars (Islahi, 2014). Insurance must not contain elements of Gharar which is also known as indeterminacy and prohibited in Islam. Its description is neither customer nor insurance company knows the occurrence of loss for which customer is taking an insurance policy. It is an established principle of Islamic contract law. Insurance being a type of indemnity, time-period of indemnity is indeterminate along with amount of money which is accrued and time when indemnity occurs. This is not the only view and others believe that this indetermination is to the extent of individual but at a broader perspective, it can be calculated and understood on the basis of rules of probability and large numbers (El-Gamal, 2001).



Gharar is argued even if it exists in the contract of insurance should be condoned on the basis of the principle of necessity, there is an undoubted need for insurance in the current world. Without insurance, large scale economic activities, different types of production of goods and availability of capital is not possible. It is also necessary because it protects against the misfortunes of life which are devastating for an entire lifetime. In this way, the contract is justified on the basis of necessity of protection of both interests of the economy and interests of the individual (Al-Saati, 2003).

Another aspect of conventional insurance which is not allowed in Islamic Insurance is Maysar translated as gambling. It is condemned in the Holy Quran in the same verse which prohibits the drinking of liquor. Insurance has been seen as a form of gambling. It is gambling if you consider that the insurance holder is betting his money or premium in the hope that if he wins the gamble by some events occurring, he will be paid by the insurer. In this case, it should be prohibited by the virtue of the verse of the Holy Quran (Holy Quran, 5:90).

It has been argued that insurance is not gambling rather a contract of indemnity. There are two arguments which are made. First that event in the case of insurance may or may not occur while in the case of gambling it must occur. Second is that in the case of insurance no new risk is created by the contract. There is a possibility of risk and the insurance contract allowed a way to manage risk but in gambling, a risk is created which could have been wholly avoided by the avoidance of gambling. These arguments cannot be considered conclusive, for example, the first argument fails because if accepted it leads to gharar or indetermination (Uddin, 2015).

Riba known as Usury is prohibited in Islamic Law. The basic aim of Islamic banking is to perform interest free activities based on principles of Shariah and carry out only Halaal (permissible) transactions. Riba is translated as usury and interest. It can be understood as an unequal exchange of something. A normal example would be banks that deal in interest on their loans and receive a greater amount of money. The first argument to be that insurance is riba as there is difference between the amount of premium paid and the coverage amount. There are multiple situations when this amount is less or is not even paid, for example; if the death, disease or disability do not occur, the contract is cancelled or there is a default in the payment of an installment. In case when the event has occurred then the coverage amount far exceeds the premium. In the first case the provider is the one enjoying



the interest in the second case the insured is the one who is enjoying the interest. This is one interpretation as an exchange of money (Mansoori, 2011).

The other interpretation in favor of insurance goes that *riba* does not exist in the insurance contract because firstly the amount paid are unrelated. The premium amount does not determine the amount of compensation on the happening of an event. The second thing to say is that the amount of compensation does not depend upon the time which has elapsed from the start of the contract so there is no *riba* in that sense. Thirdly the purpose of the contract is also taken into consideration. It is stated that those who engage in the contract of *riba* are usually motivated by monetary gains while this is not so in the case of insurance. In insurance, every person involved face a risk of loss. *Riba*, interest, or usury is strictly prohibited in Islam as dealing with *Riba*-based transactions means declaring war with Allah Almighty and His Messenger Muhammad ﷺ (Holy Quran, 2:279).

In Islam, it is possible to collect compensation for the death of a person by his family members. So in this respect, life insurance can be considered valid in principle but there are aspects of life insurance which go against the injunctions of Islam for example the collection of compensation by nominees instead of legal heirs. There is also a necessity to make liability insurance legal in Muslim countries. Since compensation is necessity, there is a need to provide compensation even when aggressor is financially weak and cannot provide such compensation (Wasti, 2006).

It is important for Islamic form of insurance to provide for some type of life insurance. Life insurance is one of the fundamental forms of insurance. People are attracted to the concept of insurance not only because it can protect their assets but also because it provides a way for them to protect their families. They can die peacefully with a sense of them having done their duty providing for their family (Shalim, 2016).

Insurance is a necessity for international trade and banking without which it cannot be conducted. So, there is a need to consider insurance not as an exchange of money which leads to *riba*. It should be considered instead as a guarantee in the same sense as one person who gives guarantee of his property to the buyer. Even viewed in this sense, it is more acceptable that insurance is a mutual individual affair rather than a commercial organized affair (Saputra, Kusairi, Sanusi & Abdullah, 2016).

### **Difference between Conventional Insurance and Islamic Insurance (Takaful)**

The main concept of conventional insurance is the reduction of risk. The three items which are considered prohibited in Islamic concept of insurance are (i) *riba*, (ii) *maysar*, and (iii) *gharrar* are all in some way present in most insurance contracts. The investment which is made in conventional insurance, that is the investment of the pool of money which has been given in the form of premium by all the policy holders of the insurance, is in the form of interest-bearing instruments. There is hence a need to formulate an Islamic version of insurance, the scholars have made great attempt in this regard but there is no agreement.

Islamic insurance is based on certain principles which are not existent in the conventional form of insurance. It is the presence of these principles that the Islamic form of insurance can be permitted. These principles serve as a base on which a larger building in the form of *takaful* can stand. The conceptual framework for Islamic insurance is different from the conventional insurance. It is by adopting this modified concept of insurance to remove defects of conventional insurance. The concept is however not a simple one. When the insurance is considered in the Islamic light many different forms emerge. These forms compete among the scholars to be declared the true Islamic form of insurance. All of them have been denied universal acceptance (Iqbal & Mirakhor, 2011).

The concept of *ta'awun* means that people are getting involved in a mutual guarantee on the basis of brotherhood and trusteeship. The people do not want to gain profit out of the dealing rather they have entered the contract as equals to joint scheme which allow them to help each other in times of need on the basis of *tabaru fund* which is a form of donation made by them. The conventional insurance does not have such concept as it is entered on the basis of earning profit from the interaction on the basis of probability. Changing the conceptual framework for the conventional form of insurance, it is possible to provide a permitted form such as joint liability fund for helping people (Ibrahim & Yaya, 2005).

Where in the concept of conventional insurance it is stated that the person pays a premium and in lieu of making that premium in a certain form and for a certain amount of time the person is indemnified against the loss and the risk of that lost is shifted from that person to another person usually the insurer. In the case of Islamic insurance, the concept of shared responsibility

states that all the people have contributed to a mutual fund and through cooperation they agree that they will help the person who has suffered a loss by collective contribution. There is no religious boundary to this action because they are not trying to shift the risk away from that person, they are simply trying to alleviate his suffering (Miranda & Farrin, 2012).

The concept of Aaqilah is customary and existed at the time of Prophet Muhammad ﷺ in multiple tribes. The concept is like the concept of blood money where the blood money becomes the responsibility of the whole tribe. In the concept of aaqilah if some sort of natural disaster is to be the fate of an individual of the tribe, then every member of the tribe would come and contribute in some form until that loss was indemnified or compensated for. This has been identified as the scholar to be the basis of takaful. (Ayub, 2003).

This shows that the concepts developed by Islamic scholars are more original than what most people expect. They do not just take the western concept and change its face to make something which fits their religion. They are in many aspects more advance and comprehensive when compared with many modern day and western concepts. (Mukhtar, Zainol & Jusoh, 2018).

In the conventional forms of insurance, there is risk distribution. The insured transfers his risk to the insurer and in that way, he is indemnified by the insurer. In the takaful concept, the insurer simply has the status of a fund manager and his role is not to take on risk. The risk is of the participants jointly to undertake and in this way, the concept of takaful distinguishes itself from the conventional form of insurance. Under this model, after paying all claim and risk fund related expenses, any profit is divided between Takaful participants and Takaful operator according to predetermined terms as the investment of this fund is basis of Mudarbah. In addition, Takaful operator also charges a service fee related to general management of risk fund. So, there is no true risk distribution in Islamic form of insurance. There is after the loss a compensation but before the loss there is no extraordinary risk taker before the occurrence of the misfortunate event (Wahab, Lewis, & Hassan, 2007).

Fund Investment is one of the key differences between conventional form of insurance and Islamic form. In Islamic form, there is a restriction on the type of investments that can be made. Usually, insurance funds are invested in interest bearing instruments or are invested in other prohibited areas such

as investment in alcohol. The investment in fixed income securities that bear interest in the conventional form is for the company to reduce its own risk. The types of restrictions which are on this fund are the same type of restrictions which fall on any Muslims. The things that a Muslim is not allowed to invest in those are unable to be invested in through the Tabaru fund (Atmeh & Hadi Ramada, 2012).

In takaful, participants have a right to know where their investments have been made and how the funds are being paid. There is no such right in the conventional form of insurance. This is based on the fact that forbidden methods of investment cannot form part of the income of a Muslim. This does not mean that people who are participating in the Islamic form of insurance can guide the fund manager, be he an individual or the government, into investing the funds in certain enterprises. The funds are kept as mudarabah investment. In this case, people are sleeping partners. They can only criticize the investment which is prohibited in Islam (Dikko, 2014).

It is therefore stated that the conceptual framework of conventional insurance and Islamic form of insurance is different. It is different firstly on the basis of the motivation of entering the contract. The motivation for takaful is not profit rather metal guarantee. It is noted that the concept of Islamic form of insurance is based on aqilah, a customary practice of the arab tribes where all members of the tribe contributed to a person who had suffered to compensate his damage. Other differences are differences of the operation aspect of the contract. The relationship between the parties is different along with the difference in the type of investment and rights that each member possesses over the other (Bakar, 2009).

### **Legal Aspect of Islamic Insurance (Takaful) in Pakistan**

Insurance Ordinance 2000 made to promote the insurance industry in Pakistan and for the protection of rights of the insurance policy holders. There is a need for this because the insurance policy holders are usually in a stronger position when it comes to negotiation. This law regulates the industry so the people are not unjustly taking advantage. This is a comprehensive piece of legislation and contained 172 sections. This ordinance is applicable to whole Pakistan (Khan, Zainuddin, & Md-Jadi, 2018).



Section 2 of this ordinance provides the definition of the important terms. The most important definition mentioned in section 2 is the definition of “Insurance”. The definition of insurance is not the definition of the Islamic insurance. This definition tells us that Pakistan has a conventional form of insurance in place which allows one party to pay a consideration in premium to the second party and the second party will if certain events occur suffer a loss in place of the first party. The problem of adopting a conventional form of insurance by Pakistan are numerous. The chief among them being that Pakistan is an Islamic State (Janjua & Akmal, 2015).

Part-II of the Insurance Ordinance 2000 is titled “Provisions applicable to the insurer” and is made up of sections 5-13. Here in this part the act provides for the registration of the insurer with the commission. It provides for all the different documents that the insurer needs to provide and then about the notices which must be given. It also provides for the revocation of such insurance and the notices which need to be given in this regard. It also provides for restrictions on types of life policies that can be given (Salman, 2014).

Part-III of the Ordinance deals specifically with life insurance companies. This part is from section 14-27. Since these are many important companies that are dealing with life insurance. It requires that they be highly regulated. Dead people have no legal personality in the law so there is a chance for these insurance companies to take advantage of situations where a person is unable to inform their family about their insurance policy. The ordinance provides for the regulation of these companies and their monitoring. It also provides for their maintenance and filing of statutory funds, those funds which they are statute bound to maintain (Khan & Other, 2020).

Since Pakistan is an Islamic country and the Constitution of the Islamic Republic of Pakistan 1973 requires that all provisions of law should not be repugnant to Islamic law. This is the first reason for Pakistan to adopt a complete Islamic insurance system. This is important because for Pakistan statecraft is the trust of Allah and when this trust is breached there is no right for Muslim to rule over that piece of land. For Pakistan, this is not only an administrative and policy issue but an issue of the religion of its people and their satisfaction (Janjua & Akmal, 2014).

Another reason for adopting Islamic insurance is that it has been shown that Islamic insurance works well. Islamic insurance is not some sub-par cheap alternative to conventional form of insurance as it is fully capable of

supporting the problems of the people and compensating them for their loss from unfortunate incidents (Khan & Others, 2011).

Another reason for implementing Islamic insurance is that the conventional form of insurance is unable to meet the issues of the people as they are not versed in the technicalities of conventional insurance and they can understand takaful more easily than the conventional insurance. Since conventional insurance can take multiple different forms without any restriction it is complicated but Islamic insurance is simple because there are a lot of restrictions in place to control Islamic insurance (Khalid & Ur Rehman, 2014).

### **Conclusion and Recommendations**

Conventional insurance is criticized due to riba, gharar, and gambling. Judging takaful on the criteria of these prohibitions, it is clear that riba resulting from investment of insurance funds through interest-based channels is completely eliminated. There is an additional improvement as takaful funds are employed into halal activities only while insurance investments are partly channeled into haram industries like casinos and liquor businesses.

Pakistan should implement Islamic form of takaful which should allow for a maintenance of takaful mainly through the government and private forms should also be allowed. There should be adaptation of Islamic law in general and all forms of laws that exist against Islam should be abolished. There needs to be transparency against corruption of the government and the investment policies of takaful. There needs to educate people at the primary level because Muslims cannot be expected to spend their life in accordance with Islam when they are not properly taught about Islam. Social media can provide a cheap alternative for education and awareness in the short term.

Due to Shariah questions and implications on Mudarbah model of surplus sharing method and legal status of this fund, there is a need for a model in which Takaful Company emerged as a welfare organization aimed at welfare of the people. There can be no justification of allowing a type of insurance that violates the fundamental tenants of Islam. Since the normal form of insurance contains interest, gambling, and ambiguity, thus it should be abandoned. This also raises questions on the conventional banking system which are allowed to exist in Pakistan since most of them deal in interest.



There is shocking lack of understanding relating to riba, gambling and gharar in Pakistan. For starters, people have not even heard the name of these Islamic terms. But more unawareness is to the true nature of these problems people do not even know what is interest. They think only the interest on money is a kind of interest and they are unaware of all its different forms. There need to be proper teaching of the people in this respect at the school level of what these great and Islamically serious concepts are. Riba is akin to waging war against Allah Almighty and his Messenger Prophet Muhammad ﷺ.

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