



UNIVERSITI SAINS ISLAM MALAYSIA

جَامِعَةُ الْعُلُومِ الْإِسْلَامِيَّةِ الْمَالِيزِيَّةِ

ISLAMIC SCIENCE UNIVERSITY OF MALAYSIA

Legal Aspects of Islamic Finance

LAB4112

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Contents

- Insurance
- Takaful

HISTORICAL BACKGROUND OF WESTERN CONCEPT OF INSURANCE

- 1. Ottoman Empire- First introduce western concept of insurance- Maritime Code 1863.
- 2. Ottoman Law of Insurance 1874-only life insurance is haram or unlawful
- Since then, western concept of insurance is practiced almost in all countries in the world

Insurance?

- Financial protection which involves the execution of contracts between the insurer and the insured in which the insurer agrees to underwrite the subject risk of such contracts.

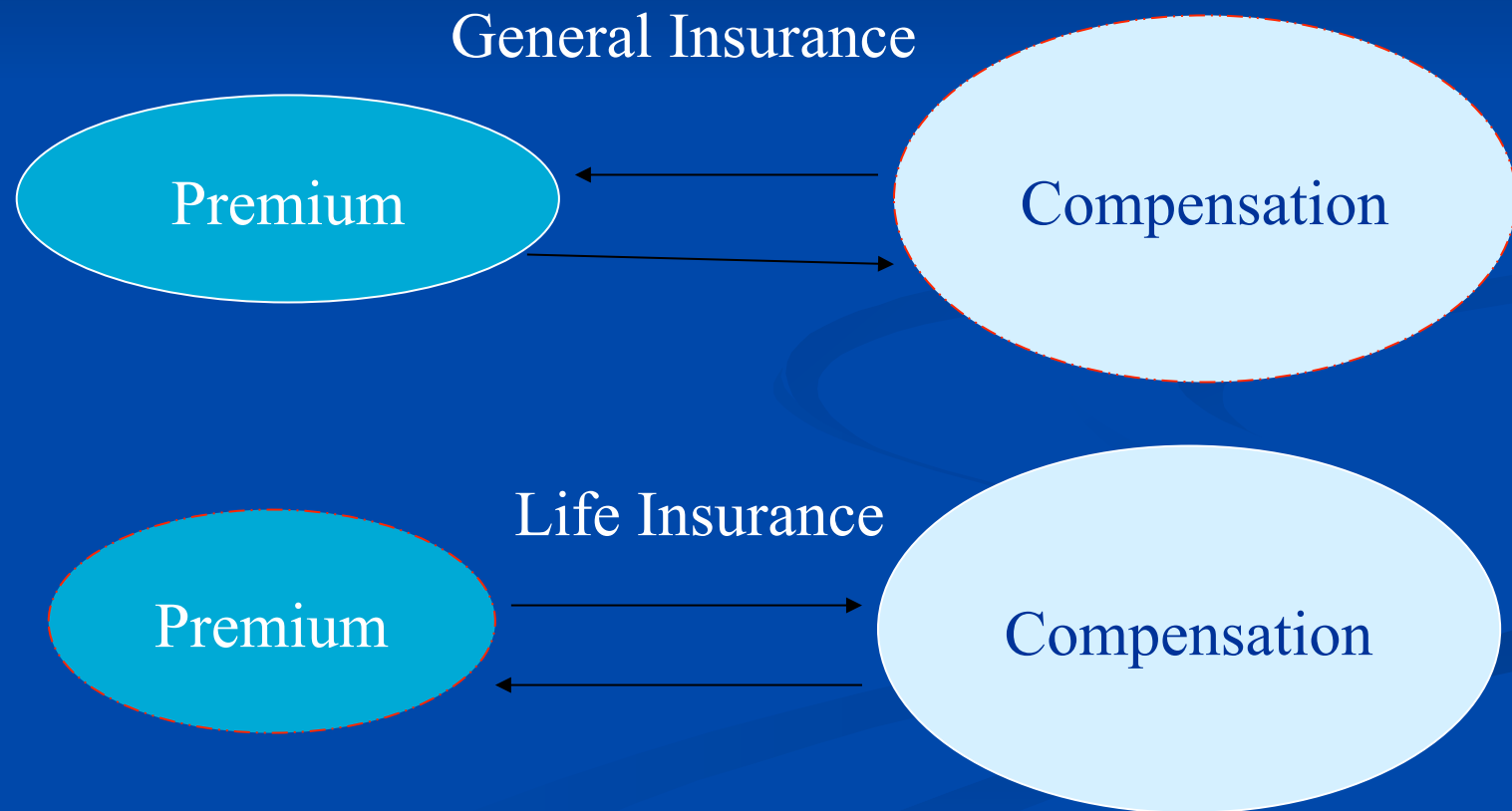
Definition

- Insurance is an economic device whereby the individual substitutes a small certain cost (premium) for a large uncertain financial loss (the contingency insured against) that would exist if it were not for the insurance.

Socio-Economic Benefits of Insurance

- Risk Coverage
- Habit of Thrift
- Safe and Profitable Investment
- Secure working environment for Businesses
- Planning for life stage needs
- Capital formation in the Economy

Nature of Insurance Contract



Shariah Position on Insurance

- Three major groups.
 - Those who consider both the concept and practice of commercial insurance un-Islamic.
 - Those who are in agreement with the present insurance and find nothing wrong in it.
 - Those who accept the concept of insurance, but find prohibited elements in its present practice.

Rulings of Collective Fiqhi Bodies

- Islamic Research Institute of Al-Azhar Uni: 1965
- Council of Grand Ulama of Saudi Arabia
- Majlis Tahqiqat-e-Shari'yah Lucknow, India
- Islamic Fiqh Academy of Rabita al-Aa'lam-e-Islami
- Al Majma' Al-Fiqhi Al-Islami of OIC: 1975
- Council of Islamic Ideology, Pakistan
- International conference on islamic economic 1976
- European Council for Fatwa.
- According to these Fiqhi bodies Conventional Insurance is unlawful because of involvement of prohibited elements

Fatwa on Conventional Insurance

- In 1972 the Fatwa Committee declared the western concept of insurance was unlawful because of gharar, riba and maisir
- In 1982- a committee set up by the govt to study the implementation of takaful.
- Fiqh Academy of the Organization of Islamic Conference (OIC) at its gathering in Jeddah in December 1985 resolved that no form of insurance, be it life or general, had conformed to the Islamic principle

Fuqaha Views on Life Insurance

- 1. Opponents:- Sheikh Shaukat, Abu Zaharah and others.
- Reason:-
 - i. Insuring one's life
 - Ii. Betting
 - Iii. Element of riba, maisir, gharar.
 - Iv. Supersede the will of Allah
 - V. against the principle of mirath
 - Vi No direct authority to justify it

Fuqaha Views on Life Insurance

- 2. Justification of life insurance but in different form namely Family Takaful.
- i. mere financial transaction through mutual cooperation.
- Ii. No unlawful element.
- Iii. Implied model of takaful-aqilah and mudharabah.
- Iv. Mutual cooperation to protect the necessities.
- V. Securing the offspring it does not supersede the will of Allah.

2. Justification of life insurance but in different form namely Family Takaful

- **Vi. Security for poor.**
- **Vii. Protection of unexpected difficulties.**
- **Viii. Self reliant society.**

OBJECTION TO THE WESTERN CONCEPT OF INSURANCE

- Riba
- Gharar
- Juhala
- Maysir
- Violation of inheritance law
- Against the concept of qada and qadr
- Forfeiture of premiums.

1. Riba

- Insurance companies invest in trade and bonds.
- Life insurance- insurer undertakes to pay the insured. The sum is in excess of the total premium paid. Premium = Loan
- Non-Life insurance- The insurance companies invested the premium paid in fixed interest earnings investment.

2. Gharar

- Uncertainty= Risk, hazard or peril
- Neither the insurer nor the insured knows the nature and extent of their rights and obligation until after the occurrence of the insured event.
- Any transaction must free from excessive uncertainty
- The insured is ignorant of the terms of the insurance.- Unacceptable reason.

How To Free From Excessive Gharar

- 1. Mutual and Cooperative basis
- 2. The takaful coverage must be genuinely required in order to safeguard interest collectively
- 3. such coverage can only be safeguarded through the insurance mechanism.
- 4. Type of contract is Unilateral Contract- Al-Tabarruat.

3. Juhala

- **Uncertainty per se-** all particulars of the contract must be known to the parties at the time of the contract. Otherwise- invalid
- **Life insurance-** The insured does not know – how long he will be paying the premiums.
- **Non life insurance-** does not know how much the insurer will pay him in the case of insured event takes place

4. Maisir

- Prohibition of unearned gains.
- To court unnecessary risk by entering into a transaction with a hope of gain as well as fear of loss.
- Undertaking a risk in the spirit of speculation
- Life insurance- If dies early-Lucky= Policy money will be paid.
- Non life insurance- if the insured event occurs- Lucky. If no- gets nothing

Cont...

- Policyholders- Pure Risk
- Insurance Co- Speculative Risk
- Premiums with promise to pay any claims

5. Violation of Islamic Law of Inheritance

- Law on Nomination- insurer can nominate to any person as beneficiaries.
- S 23- Hock Hoe's Policy. Nominee enjoys full benefit of the insurance policy.
- This objection is not relevant anymore. Amendment to the Insurance Act and introduction of the Takaful Act 1984.
- In Islam- nomination is just a trustee. The policy money must be distributed –faraid.

6. Contravention of the Conception of Pre-Destination

- Concept of *Qada* and *Qadar*- The ultimate destiny is in the hands of Allah.
- Irrelevant- Failure to appreciate the real function of insurance.
- The insurance does not prevent pre-destined events. It only reduces the pain and suffering resulting from the insured events.
- This is in fact in line with the Islamic principle.

7. Objection to forfeiture of Premiums

- Insurer may forfeit the premiums that have been paid in certain circumstances.
- May forfeit in the event of avoiding non-disclosure or breach of warranty by the insured.
- Islam does not allow the forfeiture of the capital.

Takaful

- The takaful model is based on the divine concept of taawun, which means mutual assistance. The concept of taawun is recommended in the Quran (5:2):
- “Help (taawun) one another to do what is right (birr) and good (taqwa); do not help one another towards sin and hostility. Be mindful of Allah, for His punishment is severe.”

Development of takaful

- Takaful started some 30 years ago in Sudan and Middle East in 1979 :
 - The Islamic Arab Insurance Co. (IAIC) in the UAE and
 - The Islamic Insurance Co. of Sudan
- Later in 1984, Malaysia played a pioneering role in setting the first Legal framework specific to Takaful (Takaful Act Malaysia).
- This was instrumental in the successful launching of the Takaful movement in Malaysia and in other countries of South East Asia.

Takaful Operators

- AIA AFG Takaful Bhd.
- AmFamily Takaful Berhad
- CIMB Aviva Takaful Berhad
- Etika Takaful Berhad
- Great Eastern Takaful Sdn Bhd
- Hong Leong MSIG Takaful Berhad
- HSBC Amanah Takaful (Malaysia) Sdn Bhd
- ING PUBLIC Takaful Ehsan Berhad
- MAA Takaful Berhad
- Prudential BSN Takaful Berhad

Origin of Takaful

- 1. Aqilah- Blood money
- The tribe had to be ready to compensate the heir of the victim.
- Compensation likes indemnity in insurance policy
- 2. S.Umar- Al-Dawawin System- Ministry to contribute money for emergency or in need.
- 3. Khairat Kematian-

Sources of Law Affecting Takaful

- 1. Al-Quran- elements of mutual cooperation=
Almaidah: 5:2. Alleviation of hardship= 2:201
- 2. Sunnah= Prophet said: Tie the camel first and then leave it to Allah
- 3. Practices of the companion- Al-Dawawin System by S. Umar.
- 4. Fatwa or Ijtihad: Ibnu Abidin=Permissible insurance in trade for merchant known as Sukra.
- Muhammad Abduh, Zarqa- agreed to the validity of Islamic insurance

Sources of Law Affecting Takaful

- 5. Masalih Mursalah= Life, necessity. A way of providing material security.
- 6. Urf- Tribal Custom practice known as Aqilah.
- 7. Unanimous Decision of Muslim Scholars-
- Islamic Fiqh Week Syria 1961, Muslim Scholars Conference 1965 Egypt and Islamic Economic Conference Mecca 1976- Validity of insurance business except life insurance.
- International Islamic Insurance Dubai 1996 and Labuan 1997- Validity of Takaful.

Takaful and Maqasid al Shariah

- 1. Protection of property and Protection of life: hajiyyat and daruriyyat
- 2. Legal maxim: darar must be removed.
- 3. To spread the risks of losses around the large number of participants
- Contemporary fuqaha: making takaful mandatory to muslims.
- Compulsory to protect the essential needs of the society.

Takaful

- **Kafala: responsibility, guarantee or suretyship**
- **Mutual Guarantee, shared responsibility, joint guarantee, collective assurance and mutual undertaking= mutuality and cooperation.**
- method of joint guarantee among a group of members or participants against loss or damage that may inflict upon any of them. The members of the group agree to guarantee jointly that should any of them suffer a catastrophe or disaster, he would receive certain sum of money to meet the loss or damage. All members of the group pool together their efforts to support the needy.

Characteristics of Takaful

- (i) Cooperative risk-sharing for protection
- (ii) Clear segregation between participant and operator
- (iii) *Shariah* - compliant investment strategies
- (iv) Avoidance of *riba*(interest),and *maysir*(gambling)
- (v) *Gharar* (uncertainty) is forgiven, using *tabarru* (charitable donation)
- (vi) *Shariah* advisory oversight and judicial approval

Insurance v Takaful

Issues	Insurance	<i>Takaful</i>
Organising principle	Profit for shareholders/ risk transfer	Mutual for participants
Value proposition	Profit for shareholders	Affordability and spiritual satisfaction
Laws	Secular regulations	<i>Shariah</i> plus Regulations
Ownership	Shareholders	Participants

Insurance v Takaful

Issues	Insurance	<i>Takaful</i>
Management	Company management	Operator
Contract Form	Commercial exchange/ contract of compensation-adhesion	Cooperative, Islamic Contracts of <i>wakalah</i> or <i>mudarabah</i> with <i>tabar'ru</i> donations
Investment	Equity/debt – no restrictions	<i>Shariah</i> compliant equities/ no interest
Surplus	Shareholders account	Participants account performance fee for operator

Takaful Act 1984

- S 2: Scheme based on brotherhood, solidarity, and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose.

Takaful Act 1984

- “takaful business” means business of takaful whose aims and operations do not involve any element which is not approved by the Syariah;

IFSA 2013

- “takaful” means an arrangement based on mutual assistance under which takaful participants agree to contribute to a common fund providing for mutual financial benefits payable to the takaful participants or their beneficiaries on the occurrence of pre-agreed events;

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- **S5.** takaful business shall be divided into two classes—
- *(a)* family takaful business, which in addition to all takaful business concerned with family takaful certificates shall include any type of takaful business carried on as incidental only to the family takaful operator's business; and
- *(b)* general takaful business, which means all takaful business which is not family takaful business.

Classification of Takaful

- General
- Family

General Takaful

- Short term policy
- Contribution goes to GTF which is then invested and the profits are paid back to the fund
- Contributions go to a common pool to compensate participants in the event of a loss.
- No saving and investment elements. TO will distribute any underwriting surplus to the participants.
- Eg motor vehicle, marine, personal accident, health.

Family takaful

- Long term policy (children education, pension, compensation in the event of death) 10-30 years.
- PA: saving accounts
- PSA: tabarru accounts
- In the event of a loss the participants will be compensated.
- TO: fees or profit sharing

Underlying contracts

- **Takaful Business is based on the concepts of Mudarabah, wakalah, waqf, jualah and Tabarru.**
- **Involvement of these Islamic forms of business eliminates the elements of Riba from insurance contract and convert Gharar into tolerable form.**

Nature of Relationship

- Amongst the participants- al Tabarru
- Contracts between participants and takaful operators-
 - Mudharabah
 - Wakalah
 - Jualah
 - Waqf
 - Hybrid

Contract among takaful participants

- **Tabarru:** gift or donation, which given by one in favor of someone without seeking any consideration.
- A *tabarru'* made based on the general principles of contract in which the person binds himself unilaterally by offering something valuable for the noble cause of welfare of others
- Issue: outright gift (hibah) or endowment?
- AAOIFI: iltizam bit tabarru or nihd

Concept of Al-Tabarru'

- participants' contributions credited mainly into two accounts; participant's account (PA) and participants' special account (PSA).
- PA- To be invested based on mudharabah
- The amount credited into the PSA is regarded as *tabarru'*, which is managed by the takaful operator to provide a security for others who deserve

Issue on al tabarru

- **Opponent:** it is not al tabarru but contract of exchange
 - Issue on gharar is there
 - *Al ibratu bi al maani la bi al alfaz* (one should look at the end result and not at its wording)
- **Answer:**
- (*iltizam bi al tabarru* (self imposed donation):
Maliki' s view

Contracts b/n participants and TO

- 1. mudharabah: profit sharing
- 2. wakalah: fees
- 3. jualah: commission. Commitment to pay for the performance.
- 4. waqf: TO as trustee.

Characteristics of Takaful

- 1. Mutual Help
- 2. Mutual Responsibility
- 3. Mutual Protection
- Mutual insure one another.
- Relationship- not as an insurer and insured but participants and manager of the contribution money.
- 4. Free from any element of riba, maisir, juhala, excessive gharar.

Takaful Conditions (Mutual Assistance and Cooperation)

- 1. Speciality Condition
- Compliance with the Islamic cooperative principles
- 2. Partnership Condition=
- Participants- right t entitlement of surplus profit and render liable to cover losses.
- Surplus may be paid= pro rata basis.

Takaful Conditions (Mutual Assistance and Cooperation)

- 3. Investment Condition=
- To invest in halal sectors.
- 4. Management Condition=
- Policy to have adequate representation on the board of directors of the company to scrutinize its accounts