

ISLAMIC INSURANCE *TAKAFUL* AND ITS
APPLICATIONS IN SAUDI ARABIA

A thesis submitted for the degree of Doctor of
Philosophy

by

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DEDICATION

I dedicate this thesis to my wife and children for their unconditional support and love.

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ABSTRACT

Takaful is an Arabic term meaning solidarity, which is used to describe a system of Islamic insurance that functions as an alternative to conventional insurance. Takaful, as a form of insurance, is entering a fast growing global market, promoted by the growth of the Asian economies and economic prosperity in the Middle East. The Takaful system is based on the principle of cooperation or mutual assistance, and is *Tabarru* (Voluntary), meaning that the attendant risks are spread collectively across the group of volunteers.

The Takaful system is best understood as a pact (or policy) ascribed to by a group of participants who choose to jointly guarantee themselves against loss or damage suffered by individual signatories, as confirmed in the policy. The prediction is that *Takaful* will be the default choice for citizens in Islamic countries in the near future. The combination of the system's financial efficacy, combined with principles underwritten by religious correctness has accentuated the attractiveness of this, and similar, Islamic banking and financial products to Muslims.

By examining the Saudi insurance sector, which is a market leader in the region, this thesis delivers a brief history of insurance in general and of the Saudi insurance legal framework in particular, and by so doing sheds light on Islamic insurance *Takaful* applications worldwide. It also engages in an evaluation of insurance products available in Saudi Arabia to determine whether the facilities offered by the insurance companies operating in the country incorporate obstacles and obstructions, which may impact on the effectiveness of governmental regulations and supervision in relation to setting a legislative framework. This influences the extent to which the foundations for the insurance market are secured in Saudi Arabia. The aim of the present study also leads to some suggestions and recommendations for future practice.

Table of Contents

List of Figures	xii
CHAPTER 1: INTRODUCTION	13
1.1 overview	13
1.2 The context.....	13
1.2.1 Islamic Insurance Takaful	13
1.2.2 Islamic Sharia Law	15
1.2.3 Saudi Insurance Law	16
1.3 Motivation	16
1.4 Purpose	17
1.5 The objectives of the thesis	17
1.6 The significance of the thesis	18
1.7 study capacity and justifications	19
1.8 Methodology	20
1.9 Contribution and Originality of the Thesis	22
1.10 Research Questions	23
1.11 The scope of thesis	23
1.12 Summary	24
CHAPTER 2: COMMERCIAL INSURANCE FROM THE PERSPECTIVE OF ISLAMIC SHARIA LAW	26
2.1 Introduction.....	26
2.2 Global Development of Commercial Insurance	26
2.2.1 Introduction.....	26
2.2.2 The Emergence of Insurance	27
2.2.3 The Origins and Development of Insurance	28

2.3 Principles of commercial insurance	34
2.3.1 Indemnity	35
2.3.2 Insurable Interest.....	36
2.3.3 Utmost Good Faith.....	36
2.3.4 Mitigation.....	36
2.3.5 Subrogation	36
2.3.6 Proximate Cause	36
2.4 Conventional insurance from an Islamic contract perspective	38
2.4.1 Introduction.....	38
2.4.2 The Definition of Contract (Aqd) in Islamic Sharia Law.	40
2.4.3 Basic principles and features of Islamic Insurance.....	41
2.4.4 Pillars of the Insurance Contract from an Islamic Perspective	45
2.5 An Islamic Jurisprudential analysis of the Commercial Insurance.....	59
2.5.1 Insurance as an idea or theory vis-à-vis Insurance regulation of existing contracts	59
2.5.2 Jurisprudential analysis of the rules of commercial insurance	60
2.5.2.1 Introduction:.....	60
2.5.2.2 Jurisprudential contradiction of rules of insurance	61
2.5.2.2.1 The opinion that commercial insurance is unlawful ...	61
2.5.2.2.2The view that commercial insurance is permissible: ...	69
2.5.3 The rule of commercial insurance in Islamic Sharia	70
2.6 Takaful Commercial Insurance	73
2.6.1 The Basic Principle of <i>takaful</i> Commercial insurance	73
2.6.2 Takaful Types	73
2.6.2.1 Family Takaful.....	73
2.6.2.2 General Takaful (Non-Life Insurance)	76
2.6.2.3 Re-Takaful (Re-Insurance)	77
2.6.3 The Model of Takaful	78
2.6.3.1 The Mudarabah model (share in profit)	78

2.6.3.2 The Wakalah Model.....	78
2.6.3.3 Wakalah with waqaf	79
2.6.4 <i>Takaful</i> insurance Similarities & Differences.....	79
2.6.4.1 Similarities	79
2.6.4.2 Differences	80
2.7 survey of Takaful operations	80
2.7.1 Takaful in Arabian Countries.....	82
2.7.2 Takaful in EAST ASIA.....	84
2.7.3 THE WEST	86
2.8 The Regulation of Takaful	87
2.9 SUMMARY	90
CHAPTER 3: THE MODELS OF <i>TAKAFUL</i> (<i>MUDARABAH</i>, <i>WAKALAH</i> (AGENCY), <i>WAKALAH</i> WITH <i>WAQF</i>) AND FAMILY <i>TAKAFUL</i>; THE DIFFERENTIATION OF OPINIONS AMONG ISLAMIC SHARIA LAW SCHOOLS	91
3.1 Introduction.....	91
3.2 Definition of Islamic Mutual Cooperative Insurance (Takaful)	92
3.3 Takaful Operations adopt the same rules as those applied in General Contracts ⁹⁴	
3.4 Features of Islamic Insurance (Takaful)	97
3.5 The Jurisprudential (<i>Fiqhi</i>) Analyses of Takaful Verdicts	99
3.6 The Nature of Takaful Contracts	104
3.6.1 Is <i>Takaful</i> purely a Contract of Donation or is it a Qualified Contract of Donation?	104
3.6.1.1 Issues associated with the Donation Relationship	105
3.6.1.2 Rulings of Conditional or Qualified Donation.....	105
3.6.1.3 The Obligatory Nature of the Takaful Donation.....	107
3.6.2 Is <i>Takaful</i> a Mutual Cooperative Contract, or is it a Contract of Reimbursement?	109
3.6.2.1 The Features of Contract of Reimbursement (Muawadah)...	109

3.6.2.2	Analysis regarding the Nature of Takaful Contracts	110
3.6.2.3	The Legal Relationship of Compensation between Parties ..	112
3.7	The Nature of the Legal Partnership/Relationship between Parties	114
3.7.1	The Implied Waiver (<i>Takharuj</i> and <i>Mubara'ah</i>) Relationship.....	114
3.7.2	The Relationship between Participants and the Operator	115
3.7.2.1	The Agency-Agency (<i>Wakalah</i>) Basis.....	116
3.7.2.2	The <i>Mudarabah</i> Relationship	118
3.7.2.3	The Mixed Agency- <i>Mudarabah</i> Relationship.....	119
3.7.2.4	The <i>Wakhalah</i> with <i>Waqf</i> Relationship	125
3.7.2.4.1	The Hybrid <i>Wakalah</i> with <i>Waqf</i> for South Africa....	128
3.7.2.4.2	Advantages of Takaful with <i>Waqf</i>	129
3.7.2.5	The Model of Mixed <i>Wakalah</i> – <i>Musharakah</i> Relationship.	131
3.7.2.6	Family Takaful Models	132
3.8	Issues and Ruling of Surplus.....	136
3.8.1	Surplus, Contrary to Profit	136
3.8.2	<i>Sharia</i> Rulings pertaining to Surplus	136
3.8.3	Methods of <i>Takaful</i> Surplus Distribution	137
3.8.4	Application of Surplus and Reserves for Innovation	137
3.8.5	Sharing Surplus as an Incentive to Good Performance	138
3.9	The Reinsurance Arrangement and Investment	140
3.10	Arranging a Loan Facility to cover an Insurance Deficit	141
3.11	Some Regulatory and Supervisory Considerations.....	143
3.11.1	Mechanism of Monitoring Segregated Funds.....	143
3.11.2	Risk of Misleading the Public by <i>Takaful</i> Operators	144
3.11.3	Capital Adequacy Requirements for <i>Takaful</i> Companies.....	144
3.11.4	Risks of <i>Takaful</i> Models	145
3.11.5	Application of Conventional Methods of Regulation and Supervision	145

3.12 Conclusion	146
CHAPTER 4: CRITICAL ANALYSIS OF THE SAUDI INSURANCE SYSTEM FROM THE PERSPECTIVE OF ISLAMIC SHARIA LAW	148
4.1 Introduction.....	148
4.2 The Insurance system and its consistency with the ruling regime in the Kingdom Of Saudi Arabia.	149
4.3 Characteristics of the Insurance policy in the Saudi regime:.....	151
4.3.1 The characteristics of the relationship between a specific insured person, and the remaining policy holders	153
4.3.1.1 Financial reimbursement contract (Muawadah)	154
4.3.1.2 Binding contract for both parties:	156
4.3.1.3 Contract of submission:	157
4.3.1.4 Insurance is a probable contract or a contract of deceit (<i>Gharar</i>):.....	157
4.4 Legislative qualification of the Insurance company in collecting and investing contributions as well as payment of compensations	160
4.4.1 The collected returns by the company:	162
4.4.2 The Islamic jurisprudential (Fiqhi) analysis of the insurance company, according to the insurance system in Saudi Arabia:	163
4.4.2.1 Agency contract with fixed payment	163
4.4.2.2 <i>Mudarabah</i> contract:.....	165

4.5	Legislative qualification of The Council of Cooperative Health Insurance (CCHI) in the Kingdom of Saudi Arabia:	171
4.6	Surplus and its distribution:	175
4.7	Investment of Insurance Funds	177
4.8	Conclusion	180
CHAPTER 5: APPLICATIONS OF ISLAMIC INSURANCE IN THE KINGDOM OF SAUDI ARABIA (USING NATIONAL COMPANY FOR COOPERATIVE INSURANCE (TAWUNIYA) AND AL RAJHI COMPANY FOR COOPERATIVE INSURANCE (AL RAJHI TAKAFUL) AS CASE STUDIES).		183
5.1	Introduction	183
5.2	The National Company for Cooperative Insurance (NCCI) (<i>Tawuniya</i>)...	184
5.2.1	Applicable Model.....	184
5.2.2	Definitions.....	186
5.2.3	Insurance Account, or Insurance Portfolio	188
5.2.4	Company's Commitment towards Operations Account, or Insurance Portfolio	188
5.2.5	Commitment to the Application of Islamic Law	190
5.2.6	Powers and Duties of the Sharia Board (Tawuniya).....	190
5.2.7	Surplus	192
5.2.8	Investment.....	195
5.2.9	Overall Opinion on the Applications of the Cooperative Company for Islamic Cooperative Insurance, and its Compliance with Islamic Sharia	196
5.3	Al-Rajhi Company for Cooperative Insurance (Takaful Al-Rajhi)	200
5.3.1	Applicable Form	200
5.3.2	Definitions.....	201
5.3.3	Commitment to the Application of Islamic Sharia Law	202
5.3.3.1	The Mechanism for Achieving Legitimate Compliance.....	202
5.3.3.2	Functions of the Sharia Auditing Department	203
5.3.4	Surplus	204

5.3.5 Overall Opinion on the Applications of the Al-Rajhi Company for Islamic Cooperative Insurance, and its Compliance with Islamic Sharia	206
5.4 Recommendations.....	209
5.5 Conclusion	209
CHAPTER 6: EVALUATION OF THE APPLICATION OF ISLAMIC INSURANCE TAKAFUL	212
6.1 Introduction:.....	212
6.2 The Formula of Insurance	212
6.2.1 Commercial Insurance Company	212
6.2.2 Non-profit Insurance Company (Mutual Insurance):	214
6.2.3 Islamic Insurance Company:.....	214
6.3 Evaluation of the Islamic Insurance Industry	217
6.4 Approach to the Need for Reconsideration of Insurance.....	219
6.5 Conclusion:	225
CHAPTER 7: CONCLUSION;	227
7.1 Summary of the key point in this thesis.....	227
7.1.1 Introduction	227
7.1.2 The models of takaful	228
7.1.3 Saudi Insurance law	229
7.1.4 The case studies in this thesis	232
7.2 Recommendations.....	234
7.3 Suggestions for further work.	235
GLOSSARY	237
REFERENCES	241

List of Figures

Figure 2.1: The Process of Family <i>Takaful</i>	75
Figure 2.2: The process of General <i>Takaful</i> contract	76
Figure 3.1: <i>Wakhalah</i> model (Fee based Agency)	117
Figure 3.2: Mudarabah Model	118
Figure 3.3: Family Takaful Mixed Model	120
Figure 3.4: Whakalah with Waqf Model	127
Figure 3.5 Alnoor <i>Takaful</i> in South Africa	128
Figure 3.6: Mixed Wakalah – Musharakah Model	131
Figure 3.7: Family Takaful Mudharabah Model	133
Figure 3.8 Family Takaful Wakalah Model	134
Figure 3.9 Family Takaful Mixed Model	135
Figure 3.10 The Reinsurance Agreement and Investment	141
Figure 4.1: Model applied in Al-Noor Takaful in South Africa.	165
Figure 5.1: NCCI Model	186
Figure 5.2: Al- Rajhi Takaful Model	200

CHAPTER 1: INTRODUCTION

1.1 overview

The Saudi insurance sector has become an important and leading market throughout the entire Middle East and North African region. This thesis aims to provide a brief history of insurance in general and the Saudi insurance legal framework in particular, and by so doing to shed light on Islamic insurance *Takaful* applications worldwide. It will then critically analyse insurance policies in Saudi Arabia and evaluate the facilities offered by some insurance companies in the country to highlight obstacles and obstructions which may impact on the effectiveness of governmental regulations and supervision in relation to setting a legislative framework to establish the foundations for the insurance market in Saudi Arabia. The present study discusses some suggestions and recommendations.

1.2 The context

1.2.1 ISLAMIC INSURANCE TAKAFUL

In 2009, the global Islamic insurance Takaful market was at an early stage of development, with two thirds of global premiums, \$4.8bn out of an estimated \$7.2bn in 2007 based in Iran where Takaful is the compulsory form of insurance. Global Takaful premiums have doubled from \$3.6bn over the three years since 2004. The Takaful market is mainly concentrated in Malaysia, Saudi Arabia, Kuwait, UAE and Iran¹.

The global market remains at an early stage of development with premiums estimated to have reached \$16.5bn in 2011. This includes an estimated \$4.5bn generated in Iran where takaful is the compulsory form of insurance².

¹ ThecityUK. *Islamic finance report 2009* available online at: <http://www.thecityuk.com/research/our-work/reports-list/islamic-finance-2009/> Retrieved 20-08-2012.

² ThecityUK. *Islamic finance report 2012* available online at: <http://www.thecityuk.com/research/our-work/reports-list/islamic-finance-2012/> Retrieved 20-08-2012.

The world population is almost 7 billion³, 25% of whom are Muslims. Contemporary pressures arising from the globalisation of industry and trade, increased air travel, 24/7 news media, the internet etc. are bringing an increasing awareness that we are all part of a "global village", revealing the various influences of ethnic diversity and the empowerment of affinity groups worldwide.⁴

The fastest growing sector in the field of financial services is Islamic Banking, which is seeking to address the needs of an untapped market. Over 40 countries have a Muslim-majority population and an additional 15 countries have Muslim-minority communities whose businesses and families share the same value system⁵.

Research by Ernst & Young predicts that by the end of 2015 the global *Takaful* market could reach a value of \$25bn (£15bn), up from \$9.2bn in 2010. Simon Burtwell, partner at Ernst & Young confirms that we are heading towards \$12bn this year. Furthermore, there is a substantial fast growing market worldwide, which the growth of Asian economies and Middle East are helping to drive. We can expect that *Takaful* is going to be the default choice for Islamic countries in the near future.⁶ The combination of financial efficacy and religious correctness has made Islamic banking and financial products attractive to Muslims. Every Muslim is held accountable for how he / she manages wealth and investment so as to comply with *Sharia* and declare clean profits by giving a portion to charity (*Zakat*).

The question then arises how do Muslims save for the future? Today's Muslims share similar challenges to non-Muslims as they progress through their life phases: how to finance education, marriage and the demands of family formation, as well as how to save for retirement or create an emergency fund to cover expenses that may arise from prolonged illness, or tragic misfortune. Such important yet mundane needs are typically addressed by

³ Population Reference Bureau available online : <http://www.prb.org/> Retrieved 20-08-2012.

⁴ Fisher, O. and Taylor, D. (2000) *Prospects for Evolution of Takaful in the 21st Century*. [Available online at: <http://www.takaful.com.sa/m4sub3.asp>, Retrieved 20-08-2012.

⁵ Ibid.

⁶ Barrett, S. (2011) Post online.co.uk <http://www.postonline.co.uk/post/feature/2105374/takaful-insurance-future-potential>, ThecityUK. *Islamic finance report 2012*, op. cit. Supra 2.

conventional life insurance and associated long-term savings instruments that commonly contain elements that are not permitted for practicing Muslims.⁷

The Islamic form of commercial insurance policy is *Takaful* commercial Insurance; this is a contract between the insurer and the insured, known as the policyholder, which determines the claims which the insurer is legally required to pay. The purpose of insurance is to relocate the possibility of a loss (risk) to another person (the insured), which in turn spreads out the costs of unexpected losses to many individuals. Though insurance will not eliminate the risk of death, illness, injury or property damage; insurance does disburden the insured from the financial losses brought about by this risk.

Takaful commercial Insurance is not a new concept in Islamic commercial law. Contemporary jurists acknowledge that the foundation of shared responsibility or *Takaful* commercial Insurance was prescribed by the system of ‘*Aaqilah*’⁸, which was an arrangement of mutual help or indemnification customary in some tribes at the time of the Holy Prophet; it was intended that the community contribute until the loss has been indemnified. Similarly, the idea of *Aaqilah* in respect of blood money or any disaster is based on the concept of *Takaful*, wherein payments by the whole tribe distribute the financial burden amongst the entire tribe⁹.

1.2.2 ISLAMIC SHARIA LAW

Sharia law delineates all Islamic instructions that addressed in Holy Quran and *Sunnah* of the Prophet Mohammed. Therefore, the Saudi government in Article (1) of the General Principles of the Statute of Governance Law in the Kingdom of Saudi Arabia indicates that the Kingdom

⁷ Fisher and Taylor, op. cit. Supra 4.

⁸ *Alaaqlah* are the male factions of a tribe whom relevant to the killer from his father’s side. Here, Arab traditions advocate that, in the case of murder, the *Alaaqlah* collect blood money (*Diyah*) from each of the tribe’s males to be paid to the victim’s family. See, Almir dawy. A(1480) *Alinsaf*. Ministry of Islamic affairs, Saudi Arabia. Volume 26, p50

⁹ Ma’sum Billah. M (2007). *Applied Takaful and Modern Insurance law and practice*. Asia: Sweet & Maxwell, p.5.

has taken as the Holy Quran and *Sunnah*¹⁰ of the Prophet (peace be upon him) as its constitution.¹¹

1.2.3 SAUDI INSURANCE LAW

In recognition of the fact that there has been a continuously increasing importance attributed to the role of the Saudi insurance sector, in 2003 the Saudi government officially published the Law on Supervision of Cooperative Insurance Companies and assigned the mission of supervising the insurance sector to the Saudi Arabian Monetary Agency (SAMA) which in turn declared in 2004 The implementation of regulations to interpret the execution of a new Insurance Law.

1.3 Motivation

The implications of the motivations of this thesis are derived from three main inspirations:

1. There are serious arguments between Islamic *Sharia* scholars regarding the conflict of some articles in laws and the insurance regulations published in 2003 and 2004 in Saudi Arabia, in relation to the Islamic *Sharia* rules and the General Principles of the Statute of Governance Law in the country.
2. The remarkable growth of the Saudi insurance market has been attributed mainly to expanded compulsory insurance outlets especially in the medical and car insurance sectors. Moreover, gross written premiums increased by 33.8% in the year 2009, a rise of \$ 3.9 billion (S.R. 14.6 billion) which is predicted to rise to as much as 8 billion by the year 2015.¹² Furthermore, The Ernst & Young World Takaful Report 2012 states that takaful premiums increased by 19 per cent in 2010 with global contributions totaling \$8.3 billion. The GCC accounted for \$5.6 billion of these contributions of

¹⁰ *Sunnah* is an Arabic term referring to all of the Prophet Mohammed's teachings.

¹¹ The Basic Law of Governance. (2003) Part one, General Principles, Article.1, *Translation of Saudi law, Series 2*, pp.17.

¹² Hodgins, P. and Beswetherick, M., 2009, *Insurance Regulation in the Kingdom of Saudi Arabia*, Clyde & co, International Law Firm [was Available online at: <http://www.clydeco.com/knowledge/articles/insurance-in-the-kingdom-of-saudi-arabia.cfm>, viewed 1 July, 2010] (not available now). Reattributed by SAMA Insurance Market Report 2010.

which Saudi Arabia cooperative insurance market accounted for \$4.3 billion (or 51 per cent of global contributions)¹³.

3. My *Sharia*¹⁴ background and personal interest to investigate and read about Islamic finance led me to acquire a diploma in Islamic Finance¹⁵ which highlighted the need within Islamic finance to research and evaluate models of *Takaful* contracts as an alternative solution to conventional insurance which has been forbidden in Islamic *Sharia*.

1.4 Purpose

The purpose of the paper is to evaluate whether *Takaful* commercial Insurance can operate in Saudi Arabia, within the constraints of *Sharia* Law; further, to assess whether the legal regulations in Saudi Arabia comply with *Sharia* law.

1.5 The objectives of the thesis

The objectives of the thesis are as followed:

1. To illustrate a well-structured understanding of *Takaful* insurance, insurance contracts and insurance law, and discover its similarities and differences in reference to the global model of commercial and personal insurance.
2. To identify the *Takaful* as an Islamic provision and determine its various applications on the basis of *Sharia* law, as affected by the different opinions expressed at *Fiqhi* (jurisprudential) schools.

¹³ Hodgins. P and Owen.M. *The Saudi Arabian Cooperative Insurance Market: The premier League of Islamic Insurance*. Clye & co. Available online: <http://www.clydeco.com/insight/updates/the-saudi-arabian-cooperative-insurance-market-the-premier-league-of-islami> 20-08-2012.

¹⁴ I graduated from Imam Mohammed bin Saud Islamic University in Riyadh.

¹⁵ This diploma was obtained at The Markfield Institute of Higher Education (MIHE).

3. To discuss and analyse the Islamic Sharia perspective in insurance contracts and demonstrate the views of the modern Muslim scholars.
4. To determine the legal conflict between the law of Supervision of Cooperative Insurance Companies and its implementation regulations in Saudi Arabia and the most significant barriers towards these.
5. To examine the effects of implementation regulations upon companies' performance and to observe whether or not they comply with Sharia law. Also, how the requirement of Islamic insurance *Takaful* works under Saudi Law.
6. To confirm how the Islamic vision reflected by Islamic experts and scholars impacts upon insurance companies and those applying and implementing regulations.
7. Finally, to attempt to find rational solutions to enhance the legal steps to provide an Islamic legal safe ground corresponding with the needs of the national market and the growth of Takaful industry.

These considerable issues are an attempt to provide Islamic legal solutions that are in compliance with the growth of the market, and which also meet the requirements of Islamic law.

1.6 The significance of the thesis

The significance of this thesis is derived from the importance of its subject; it will not seek to justify commercial insurance forbidden by Islamic law, but rather to enhance the Saudi insurance laws so as to benefit from the highly developed regulations and applications worldwide.

Therefore, this thesis is not going to introduce a hypothesis for a form of insurance, so as affecting the financial engineering business, it is instead intended to legally prove that an Islamic Insurance *Takaful* application is applicable and profitable, by studying the models of *Takaful* worldwide. In addition, it seeks to assure that forms of solidarity between

policyholders, so as to cooperate with and guarantee each other with regards to whether one of them can be successful.

Furthermore, one of the significant contributions of this thesis is that it is going to identify the extent to which governments or companies are not applying *Sharia* rules. To achieve this it will critically analyse Saudi insurance laws, regulations and companies' applications as evidence of compliance or non-compliance with Islamic *Sharia*.

One of the most important and significant impact of this thesis is access to resources. I refer in this thesis to numerous books in Arabic which are considered as primary and secondary resources in Islamic law and Insurance. Thus, considerable effort has been expended to translate many important legal insurance and *Sharia* texts from Arabic to English; an effort which represents a significant addition and positive contribution to researchers working in the Islamic insurance field.

1.7 study capacity and justifications

The Saudi Arabian Monetary Agency (SAMA) is the department responsible for the regulation and supervision of the insurance industry in Saudi. Article 1 of the law of Supervision of Cooperative Insurance Companies in Saudi Arabia held that "Insurance in the Kingdom shall be undertaken through registered insurance companies operating in a cooperative manner as it is provided within the article establishment of the National Company for Cooperative Insurance and in accordance with the principles of Islamic *Sharia*"¹⁶. However implementing the regulation for this law clearly conflicts with this article as does making it comply with conventional insurance instead of the cooperative insurance subject matter, which raised a considerable number of legal issues as discussed among legal experts, lawyers, judges and economic experts. Their opinions can be summarised as:

- The implementing regulation does not disclose the nature of cooperative insurance or its criterion.
- In Article 61, relating to the investment account, it is not permitted to invest in governmental and foreign bonds which are prohibited in *Sharia* law because of *Riba*.

¹⁶ *Law on Supervision of Cooperative Insurance Companies in Saudi Arabia*. Published by Saudi Arabian Monetary Agency (SAMA) available online on; <http://www.sama.gov.sa/ar/control/procedure/Insurance.pdf>

- They confirm that the implementing regulation must comply with the provision of the Law on Supervision of Cooperative Insurance Companies.

1.8 Methodology

Commercial and Family insurance in its conventional format contravene many Islamic Shariah Injunctions such as prohibition of *Riba* (Interest), the business of speculative transactions and al-maisir (gambling). On the other hand commercial and family insurance are increasingly becoming the basic need for the people. This research is aimed to explore the Islamic Sharia literature to develop a framework to provide necessary insurance framework while complying with the Shariah injunctions as laid out in Quran and Sunnah, the two major sources of law in Islam.

Creswell (2003)¹⁷ suggested that in social science research is conducted to perform one or many of the following tasks:

- Explore and idea
- Probe an issue
- Solve a problem
- Make an argument that compels us to turn to outside help

This research is an attempt to explore the idea of insurance in Islamic framework and develop a model to meet the 21st century requirements of people in the Muslim world, especially in the Kingdom of Saudi Arabia. In its very nature this is a primary research in the field of Islamic law where an attempt is made to study the features of the commercial and family insurance and develop a Sharia compliant framework to develop an insurance product to meet the needs

¹⁷ Creswell, J. W. (2003). *Research Design: Qualitative, Quantitative and Mixed Methods Approaches*, CA: Sage Publications.

of people. The research is conducted in the context of the Kingdom of Saudi Arabia. Nonetheless, the findings and model formulated in this research is applicable to all the Muslims world.

In this research an inductive approach is adopted to answer the research questions and achieve the aims of the research.

While epistemologically this research followed an Interpretivism approach. Bryman (2008) suggests that interpretivism¹⁸ is an approach where researcher is aiming to place the interpretations that have been elicited into a social scientist framework. In this research an effort is made to interpret other's interpretations and later these interpretations are associated with the concepts, theories and literature on Sharia law and conventional law of commercial and family insurance.

In order to achieve the aims of this research, a careful study on the writings of Sharia law scholars and conventional Insurance discipline is important. The writings of conventional law, economics and finance helped to understand the framework and practices of the insurance industry while Shairia writings were studied to development an argument against the current practices of insurance industry. The research also provide an in depth analysis the law and practices of Insurance industry in the Kingdom of Saudi Arabia. Later an effort was made to develop a purposeful argument to chalk out a sharia compliant framework to provide commercial and family insurance. In order to place the established ideas of the *fiqh* scholars into a proper context the literature developed by contemporary Islamic economists and finance experts were also reviewed.

In summary an interpretive research approach was adopted to conduct an inductive and analytical study of insurance in Islamic framework and later to develop a Sharia compliant model of Insurance. Furthermore, the research explores the Takaful i.e. Sharia compliant

¹⁸ Bryman, A. (2008). Social Research Methods, Oxford: Oxford University Press.

insurance in the context of Kingdom of Saudi Arabia and developed a general model based Sharia guidelines which could be implemented across the Muslim world.

1.9 Contribution and Originality of the Thesis

The thesis, is an evaluation of the legal and jurisprudential concept of *Takaful* Commercial Insurance and its application in Saudi Arabia, as an Islamic insurance concept, which is grounded in Commercial transactions (*Muamalat*), and observes the laws and regulations of Saudi Arabia in accordance with *Sharia* (Islamic law); which was established more than 1431 years ago.

Therefore the originality and contribution of the work can be outlined as follows:

1. I was interested in writing my thesis and yet found that it was not an easy task to deal with two mentalities and two languages; namely (Arabic and English). Furthermore, using primary and secondary resources in Islamic law to transfer knowledge from one to another was the most difficult challenge I faced, and I found it of significance to this thesis. Therefore, the huge amount of Arabic resources used in this thesis will make it original.
2. All the *Takaful* models applied worldwide were dispersed in books, at companies' websites and with financial reports, and I gathered them all together in one book with critical analysis and evaluation according to Islamic *Sharia*. These tasks were not entirely linked to my reading and I do believe they will make a good addition to the Islamic law and finance library.
3. Saudi Arabia is an important country within the Muslim world and all Muslims confirm that the Saudi government applies *Sharia* in all its transactions, and there is rarely ever a critical analysis of Saudi insurance laws published, from either a legal or a financial perspective. Therefore, studying Insurance laws in Saudi Arabia and implementing its regulations and conducting a critical analysis involves enhancing this important law based on considerable recommendations that will legally benefit the Insurance sector financially not only in Saudi Arabia but also in other Muslim countries.

4. I have studied the practices of the largest two companies in Saudi insurance market: the National Company for Cooperative Insurance NCCI (Tawuniya) and Al Rajhi Company for Cooperative Insurance (Al Rajhi *Takaful*) as case studies in this thesis; applying qualitative and quantitative methods, thus all recommendations and results will certainly benefit the companies themselves and their clients.

1.10 Research Questions

The questions proposed by this thesis are;

1. Do *Takaful* applications provide suitable solutions to resolve insurance problems?
2. To what extent does the legal framework of insurance in Saudi Arabia comply with Sharia law?
3. Do applications of *Takaful* companies in Saudi Arabia meet Sharia law requirements?

1.11 The scope of thesis

To answer the questions above I have divided my work into six chapters:

Chapter 1: Commercial Insurance from the perspective of Islamic Sharia Law,

This chapter will present a historical background to the insurance development; I will identify the concept of insurance and its principles in relation to Islamic Sharia, as an introduction to the research.

Chapter 2: The Models of *Takaful* Contract,

This chapter will describe and critically analyse the Models of *Takaful* (*Mudarabah*, *Wakalah* (agency), *Wakalah* with *Wakf*) and Family *Takaful* and the differentiations of opinions between the different schools of Islamic *Sharia* law.

Chapter 3: Critical analysis of the Saudi insurance system from the perspective of Islamic Sharia Law.

In this chapter I will undertake a critical study of Saudi insurance law and its consistency within the Saudi regime, and of Islamic Sharia as a constitution for the Kingdom of Saudi Arabia.

Chapter 4: Applications of Islamic Insurance in the Kingdom of Saudi Arabia (using National Company for Cooperative Insurance (Tawuniya) and Al Rajhi Company for Cooperative Insurance (Al Rajhi *Takaful*) as case studies).

In this chapter I undertake a legal evaluation for the applications of Islamic Insurance Companies in Saudi Arabia using the National Company for Cooperative Insurance (Tawuniya) and Al Rajhi Company for Cooperative Insurance (Al Rajhi *Takaful*) as case studies.

Chapter 5: Evaluation of the Application of Islamic Insurance Takaful.

This chapter will evaluate the formulas and methods applied for attaining both Islamic and conventional insurance, considering commercial insurance, mutual insurance, and Islamic insurance. At the close of this chapter I will include some ideas for the possible enhancement of the Islamic insurance field.

Chapter 6: Conclusion

This chapter will give a summary of the key point of the thesis following by recommendations and suggestions for further work.

1.12 Summary

This introduction has provided a brief synopsis of the Legal and jurisprudential concepts associated with Islamic Mutual Cooperative Insurance *Takaful* and its application in Saudi Arabia; also covering some personal reflections; the purpose, aim, methodology and scope of work.

The next section, Chapter 2, will examine the distinctiveness of Conventional Insurance under Islamic *Sharia* law, logically presenting a chronological timeline for Insurance, its features, principle and pillars of insurance per se, and the role and effects of *Fiqhi* [Islamic Jurisprudence] on the legality or otherwise of Insurance in Saudi Arabia.

CHAPTER 2: COMMERCIAL INSURANCE FROM THE PERSPECTIVE OF ISLAMIC SHARIA LAW

2.1 Introduction

Islam is a global phenomenon; its influence on both people, and the economy, is widespread. For a long time, Muslims have conducted their lives and businesses abiding by the extensive teachings associated with Islamic principles. These principles confirm equality, advocate mercy and promote cooperation and shared responsibility among those undertaking business transactions. However, as the insurance business routinely deals with the uncertainty of loss, and does not conform to Islamic conventions, insurance has long been discouraged within Islamic society. Nevertheless, this same society has awaited development with regard to this important aspect of life.

In view of the above, Chapter 1 will examine the distinctiveness of commercial insurance under Islamic Sharia law, covering the following points: a global and historical overview of commercial insurance considering *Takaful* Commercial Insurance as an alternative solution; significant and distinctive features of insurance; pillars and principles of insurance; the developmental effects of *Fiqh* (Islamic Jurisprudence), and the views of Muslim scholars, experts and economists, influencing changes introduced over the last 3000 years.

2.2 Global Development of Commercial Insurance

2.2.1 INTRODUCTION

The following section highlights the global development of commercial insurance throughout the ages, concluding by depicting the current position. Initially, for example, Vaughan, E. J.(1997) has confirmed that early methods of transferring, and/or distributing, risk were practised by Chinese and Babylonian traders as early as the 2nd and 3rd millennia BC¹. Here,

¹Vaughan, E. J., 1997, *Risk Management*, New York: Wiley. quoted from http://en.wikipedia.org/wiki/History_of_insurance . Retrieved 2012-08-06.

Chinese merchants travelling over treacherous river rapids would redistribute their wares across many vessels in order to limit losses due to individual boats capsizing.²

2.2.2 THE EMERGENCE OF INSURANCE

Established in 1750 BC, Hammurabi's Code pioneered the processes and procedural aspects of insuring goods and protecting citizens by applying 'just and fair' practices. One thousand years later, the inhabitants of Rhodes developed the concept of 'general averages'. Merchants whose goods were shipped together, en masse, would pay a proportionally divided premium intended to reimburse any merchant whose goods were jettisoned during storm or wreckage.³

The Achaemenian monarchs of Ancient Persia, were first to insure citizens in an official capacity by registering the insurance process in governmental notary offices. An insurance ceremony was performed each year in Norouz⁴ where the heads of different ethnic groups willingly presented gifts to the monarch. The most important gift was presented during a special gathering. When a gift's value exceeded 10,000 Derrik (Achaemenian gold coins) the gift was registered with an assigned office. This system was advantageous to those who presented costly gifts. For others, less expensive offerings were impartially assessed by confidants of the court; these assessments were then registered via designated offices⁵.

In short, this early example of an inventory system meant that those registered as having presented gifts at court, would be assisted by both the monarch, and the court itself, in times of need. Further, wherever the registered amount exceeded 10,000 Derrik, donors would be eligible to receive twice this amount in aid.⁶

² Ibid.

³ Ma'sum Billah. M (2007). *Applied Takaful and Modren Insurance Law and Practice*. Sweet & Maxwell Asia 2007. P5

⁴ The Beginning of the Iranian New Year.

⁵ Iran Law. *Insurance in Ancient Iran*. available online at : http://www.iran-law.com/article.php3?id_article=61 . Retrieved 2012-08-06.

⁶ Ibid. Also available as well at: http://en.wikipedia.org/wiki/History_of_insurance . Retrieved 2012-08-06.

2.2.3 THE ORIGINS AND DEVELOPMENT OF INSURANCE

In c. 600 AD, Greek and Roman citizens fanned the origins of health and life insurance via forming guilds known as ‘benevolent societies’. These guilds provided care for families, and paid funeral expenses for subscribing members upon death.⁷

Further to this, Macpherson observed that in the year “51”, of the first century, Claudius, the Roman emperor, invented ship insurance by encouraging import merchants to buy corn (important to Roman survival), all year round including the winter months. The emperor stated that this would protect against losses and accidents which might arise from “the inclemency of the season”, and he also made the importers could be sure of a certain rate of profit.⁸

Nevertheless, Park claimed that insurance was ‘wholly unknown’ to the ancient world, insisting that there is little to intimate “the smallest proofs of the existence of such a custom have not come down to the present times”. Park undertook an exploration of the history of the insurance contract and examined the laws of Rhodes, Romans, Amalfi, Oleron and Wisbuy, yet found no evidence of these practices.⁹

However, in Holdsworth’s ‘History of English Law’¹⁰, the author unearthed a number of contracts modelled on insurances, presenting various samples of stipulations that Greek and Roman traders would include in contracts of carriage. These stipulations were designed to modify the risk of damage to cargo carried out on either the consignees’, or the carriers’, behalf.¹¹

⁷ Ibid.

⁸ Macpherson, David, *Annals of Commerce*, (London: Nichols, 1805). Vol. I, p. 151. Although Macpherson believes that this event is the only possible origin of insurance, personal enquiry has prompted me to disagree with him on this point. It seems to me that support was provided to merchants by the emperor (Claudius), as the highest authorised power, outweighing any support from government, during extraordinary economic circumstances in order to safeguard the economy, and empire, from national suffering. Also, Macpherson’s example does not seem to constitute a commercial contract between two parties, where one undertakes action, in consideration of a premium, to indemnify the other for losses caused by certain events. Therefore, to me, insurance was not yet established during this period of time, but instead, can be recognised as a governmental guarantee, rather than a commercial transaction.

⁹ Algamdi, E. (2006) *Insurable Interest in property insurance: A Comparative study amongst English, Canadian and Saudi Arabia Laws*. University Of London University College London Faculty Of Laws 2006. For more information see the Author’s comments in the footnote. P 26.

¹⁰ Holdsworth, William S., *A History of English Law*, (London: Methuen & co. ltd., 1925). Vol. 8, p. 274.

¹¹ Holdsworth, *Ibid*.

A range of legitimate Islamic insurance provisions have been issued throughout both recent, and distant, history. The first of which is in the form of a quotation from Ashhab, one of the Maliki scholars who lived during the second half of Hijra in the year (815, approx.). Ashhab stated that “A guarantee should not centre on a certain price, but must instead involve agreement, from one man to another, to assure a commodity for a certain length of time. If not, paying guarantor money for a matter other than sale or purchase, essentially represents uncertainty and gambling”.¹²

It has also been claimed that insurance was established by the Jewish population as a result of being exiled from France by Philip Augustus in 1182. In fact, The Talmud deals with several aspects of insuring goods. According to this perspective, after settling peacefully in Italy, past experiences stirred this community to secure their property, should they be banished again. It is said, the success of this insurance contract was noticed by merchants in northern Italy, who “were struck with its utility, were prompted to adopt and extend its use”¹³.

Indeed, Marshall stated that, “..., according to Cleirac, bills of exchange and policies of insurance are of Jewish birth and invention, and have nearly the same name, Polizza di cambio, Polizza di sicurezza. He adds that the Italians and Lombard’s, who were spectators of this Jewish intrigue, and the instruments employed in conducting it, preserved the forms of these instruments, which they afterwards well knew how to avail themselves of, in conveying out of Italy the effects of the Guelph’s, when driven from thence by the Gibbelines.”¹⁴

Although Marshall did not accept this view, Duer, with some scepticism, did. On this point, Duer states that “the sagacity of the Jews, in matter of finance is well known, and they were placed in circumstances of difficulty and distress that were well calculated to sharpen their invention. That they would resort to some expedient for averting or diminishing the losses to which they were exposed, we may certainly believe, and the expedients of insurance and bills

¹² Alswailam, S. (2009). *stoppages in Insurance Issue*. International Islamic Bureau for Economic and Finance. Available online http://www.sfhatk.com/vb/uploaded/471_21252008374.rar. Retrieved 2012-08-06

¹³ Duer, J. (1945), “*The Law and Practice of Marine Insurance*”, (New York: J.S. Voorhies). Vol. I., p. 30.

¹⁴ Marshall, Samuel. (1805), “*A Treatise on the Law of Insurance*”, (Boston: Printed by Manning and Loring, for D. Johnson).p 4.

of exchange which they are said to have invented, at the same time, admirable suited to accomplish their object.”¹⁵

Duer presented factual, linguistic evidence that the insurance contract originated in the early 13th century in Italy, and claimed that “The Italian, alone explains its meaning and propriety. The word "Polizza," in Italian, signifies any note or memorandum in writing, creating, or evidence of a legal obligation; and hence the name is applied, with the same propriety, to a bill of exchange, a promissory note, and even to a receipt for money as to the written agreement of insurance. It seems a safe conclusion that insurance originated in the country, the language of which, has given to the agreement of the parties its distinctive appellation”¹⁶.

As previously mentioned, during the thirteenth century, the Lombards, a group of Italian merchants, adopted insurance agreements, and according to Park, were the first to present these contracts of insurance to the world.¹⁷

According to Marshall, the Lombards played an important role in Europe. During the 12th and 13th centuries, the commerce of Europe was almost entirely in the hands of the Italian Lombards, with companies and/or factories based in almost every European State. From thence, they became the only contending merchants and bankers, and “in those times, rivalled ... the Jews themselves in the art of usury”¹⁸.

Ahmed Ben Yehia (1436), a Muslim scholar, stated that any “Guarantee for stolen or sunken objects is null void”¹⁹. This assertion is fully applied in both maritime insurance and fire insurance.

Furthermore, El Qorra Daghi (2006), has suggested that these fatwa’s²⁰ do not constitute decisive evidence that the issue of insurance was known to Islamic Sharia scholars at this time.

¹⁵ Duer, *supra* footnote 13 , pp. 30, 31.

¹⁶ Duer, *ibid*, p. 29.

¹⁷ F. Hildyard, J. A. Park, *A System of the Law of Marine Insurance* (1842), (Abingdon, Oxon.: Professional Books, 8th ed., 1987).), Vol. I, lxviii .

¹⁸ Marshall .*supra* footnote 14, p.10

¹⁹ Ahmad ibn Yahya (840H) (1436). *Albahar Alzaikher*. Alrisalah Establishment Puplicher. Beirut.

²⁰ *Fatwas* is an Arabic term meaning a formal opinion offered by a highly respected and well known scholar or institution.

Nevertheless, El Qorra Daghi (2006) added that, particularly in the case of maritime law, it might be possible that insurance already existed and prevailed in the West before Ahmed Bin Yehia's time²¹.

Dickson (1960) confirms that some forms of insurance had developed in London by the early decades of the seventeenth century. For example, the will of the English colonist Robert Hayman mentions two "policies of insurance" taken out with the diocesan Chancellor of London, Arthur Duck. To the value of £100 each, one policy relates to the safe arrival of Hayman's ship in Guyana, and the other, is in regard to "one hundred pounds assured by the said Doctor Arthur Ducke on my life". Hayman's will was signed and sealed on 17th November 1628. However, this was not verified until 1633²².

UK Insurance, as we know it today, can be traced to the Great Fire of London, which in 1666 devoured more than 13,000 houses. The devastating effects of the fire converted the development of insurance "from a matter of convenience into one of urgency, a change of opinion reflected in Sir Christopher Wren's inclusion of a site for 'the Insurance Office' in his new plan for London in 1667."²³

Nevertheless, a number of attempted fire insurance schemes came to nothing. However, in 1681 Nicholas Barbon, and eleven of his associates, established England's first fire insurance company, the Insurance Office for Houses, at the back of the Royal Exchange. Initially, 5,000 homes were insured via Barbon's scheme.²⁴

Toward the end of the seventeenth century, London's growing importance as a centre for trade increased demand for marine insurance. In the late 1680s, Edward Lloyd opened a coffee house, a popular haunt for ship owners, merchants, and ships' captains. Lloyd's coffee house thereby became a reliable information centre regarding the latest shipping news. The cafe

²¹ El Qora Daghi.A (2006). *Islamic Insurance*. Dar Albashaer Alislamia. Beirut, Lebanon.

²² Dickson, P.G.M. (1960). *The Sun Insurance Office 1710-1960: The History of Two and a half Centuries of British Insurance*. London: Oxford University Press. pp.324.

²³ Ibid.

²⁴ Ibid.

became the meeting place for parties wishing to insure cargoes and ships, and those willing to underwrite such ventures²⁵.

Today, Lloyd's of London²⁶ remains the leading market for marine and other specialist types of insurance.

According to Dickson, the first insurance company in the United States underwrote fire insurance and was formed in Charles Town (modern-day Charleston), South Carolina, in 1732. Benjamin Franklin helped to popularise, and make standard, the practice of insurance, particularly against fire, in the form of Perpetual Insurance.

In 1752, Franklin founded the Philadelphia Contributionship for the Insurance of Houses from Loss by Fire. Franklin's company was the first to make contributions toward fire prevention. Not only did his company warn against certain fire hazards, it refused to insure certain buildings where the risk of fire was too great, excluding all wooden houses for example.

In the period loosely dated between 1770 and 1820s, Britain experienced an accelerated process of economic change, transforming a largely agrarian economy into the world's first industrial economy. This phenomenon is referred to as the "industrial revolution", since changes were all encompassing and permanent.²⁷

The first Arabic scholar to talk about conventional insurance provision was Ibn Abideen (1836) stating “It is tradition that if/when traders rent a boat from a non-Muslim, they pay him a wage however, an extra amount is paid to another person living within the native country; this extra money was called (*SOKRAH*²⁸)”. Here, should any possessions/money perish via fire, wreckage or theft, the native guarantor holds this money against what has been lost. Abideen then noted “I think that traders have no right to take compensation for damages”²⁹.

²⁵ Ibid.

²⁶ Note that it is not an insurance company.

²⁷ Ibid.

²⁸ This word (*SOKRAH*) originally derived from a French word ‘securite’, and in Arabic dictionaries means insurance or guarantee. Altwajery. A (2009). *Altaameen almua’asir fi muzan alsharia*. King Saud University. Saudi Arabia, Riyadh. P22.

²⁹ Ibn Abideen(1836), Ibn Abideen Comment, Dar ehiaa Alturath, Beirut, v 3, P. 249-250

In Arab countries, an explanation of relations between contracting parties is considered definition of contract. Representing the most ancient principles, Egyptian civil law defines a contract as “...an agreement by virtue of which the insurer is committed to pay the insured, and/or the beneficiary, an amount of money, revenue and/or financial reimbursement, in the event of pre-agreed incident or danger, against a premium or any other financial payment paid by the insured to the insurer”³⁰.

This definition has been adopted by Kuwaiti civil law, article no. (773)³¹, Syrian civil law, article no. (713) and Libyan civil law, article no. (947)³².

Imported to Arab countries from the west in the 19th century, Commercial Insurance was considered a foreign pact intended for Muslim Arabs. The emergence of the insurance contract in Arab and Muslim countries motivated Islamic scholars and legal experts to consider this matter closely.

At this juncture, Scholars and Islamic institutions made every effort, using Islamic jurisprudential methodology, to understand and form logical critical analyses of the insurance contract; further highlighting the features of this type of contract, including what makes it distinct from others. Scholars also provided an in-depth analysis, dividing the contract into pillars and submitting an appropriate description for each pillar according to Islamic Sharia Law.

In December 1906, the Egyptian Court resolved that the act of claiming compensation for life insurance is legally void due to being impermissible³³.

In 2008, the G20 countries suffered economic meltdown with the collapse of governments, high-street and investment banks, and insurance companies being declared bankrupt. Millions of people throughout the world have since been affected by the financial chaos, dishonesty and

³⁰ El Sanhoury.A (1964) El Wasit in Explaining Civil Law, Dar Alnahadah alarabiah, V 7, P. 1084.

³¹ Sharaf El Din. A (1983) Insurance Provisions in Law and Judiciary, Kuwait University Edition, P. 18.

³² El Gammal. G (2007), Commercial Insurance and Islamic Alternative, Dar El Eatesam Edition 2009, Cairo, Eisa Abdo (2004), Insurance Between Permission & Prohibition, Dar El Eatesam Edition 2004, P. 8.

³³El Qora Daghi. A (2006). Supra footnote 22.

lack of transparency³⁴. The cornerstone features and pillars which *Takaful*, is based on, are now under threat. To date, the insurance market is in turmoil. *Takaful* is proposing to reinforce the Islamic pillars of service excellence via the following principles: policyholders co-operate among themselves for the common good; every policyholder pays a subscription to help those that need assistance; losses are divided and liabilities spread according to the community pooling system; Uncertainty is eliminated in respect of subscription and compensation, and no one member of the scheme derives advantage to the cost of others.

2.3 Principles of commercial insurance

Insurance is deemed to be one of the most important financial tools and one of the main supports of the global economy. This is due to the financial liquidity provided by these companies, which enhances the state economy and supports its indicators.

Established principles of insurance give confidence to the investor, particularly when aspects of danger are multiplied over sea and air and, in addition, the ratio of crime has risen in economic countries. However, the mechanisms involved in applying these Principles have, in the past, been met with religious opposition from the global Christian church. What is more, this rejection was consolidated by Muslim scientists following the emergence of Islam.

More significantly, in order to form the foundations, and to develop the shape, of insurance, Holdsworth argued that, in the 14th century, insurance was modelled on maritime loans, developed into Bottomry contracts. With the maritime loan, “the debtor declares that he has received an advanced sum, and promises to restore an equivalent sum upon the safe arrival of the ship and/or goods, as compensation. In this instance, the insurer plays the part of the debtor, declaring that he has received the amount for which the ship and/or goods are insured, and promises to repay this sum in the event of the ship and/or goods failing to arrive safely”.³⁵

³⁴Anup Shah (2010). *Global Financial Crisis*. Global Issues webpage. Available online at: <http://www.globalissues.org/article/768/global-financial-crisis> Retrieved 10- 08 -2012.

³⁵ Holdsworth, William S, supra footnote 10, p 277

Holdsworth further stated that, “It was only natural ... the earliest insurers should be ship owners”, since these merchants could “...charge a smaller premium because they...” were better placed to “...guarantee a safe arrival”. Therefore, the author concluded, “...it was inevitable that those who drew up the earliest agreements should be the same people drawing up contracts of loan based on Bottomry”. Hence, it was from the latter contract that much of the most important, technical terms were originally taken, such as "policy" and "premium" for instance. These terms remain applicable to the present day³⁶.

Thus, Holdsworth identified two principles of insurance law based on this concept. The first, was the principle of insurable interest. This meant that “the insured must be the owner, or at least have some interest in the property insured”. “A man cannot transfer to another, what he does not own”³⁷.

Therefore, Holdsworth inferred, “from the outset, the insurance agreement was a true contract of indemnity, as opposed to a mere wager on the safe arrival of a ship or its merchandise”. The second principle upheld that, “if a ship or goods did not arrive safely, and the Resolutive Condition³⁸ failed, the insurers were entitled to as much of the insured property as could be recovered”³⁹.

Both recently, and formerly, the Principle of insurance has been met with support regarding the concepts of joint liability, solidarity and the decrease and/or removal of risk.

2.3.1 INDEMNITY

Indemnity – Insurance is essentially a contract of indemnity where the insurance company indemnifies the insured against certain risks for a consideration known as a premium⁴⁰.

³⁶ Ibid.

³⁷ Ibid.

³⁸ Resolutive condition is, in *civil law*, a condition that, upon fulfilment, terminates an already enforceable obligation and entitles the parties to be resorted to their original position. B. A. Garner, *Black's Law Dictionary*, 7th ed., (1999), p. 290.

³⁹ *Ibid*, 278.

⁴⁰ Mehr. R and Camack. E. *Principles of Insurance*. Richard D Irwin, 6th edition, 1976, pp 34 – 37.

2.3.2 INSURABLE INTEREST

Insurable interest – signifies the loss of goods or services which directly affect the insured.⁴¹

2.3.3 UTMOST GOOD FAITH

Utmost good faith – refers to both the insured, and the insurance company, agreeing that neither should wilfully hide anything of relevance from the other.⁴²

2.3.4 MITIGATION

Mitigation – denotes that the insured will behave responsibly and take due care so that risk of loss, or actual loss, is minimised.⁴³

2.3.5 Subrogation

Subrogation – means the insurance company acquires the legal right to act on behalf of the insured i.e. the insurance company steps into the shoes of the insured.⁴⁴

2.3.6 PROXIMATE CAUSE

Causa Proxima or Proximate Cause – involves establishing the reasons behind loss in order to ascertain whether this loss is covered under the policy.⁴⁵

During the reign of Charles II's and Queen Anne, new forms/policies of insurance were developed via expressed agreements. These policies discharged a merchant from having an interest in the insured object and/or subject matter. In addition, the insurer promised to pay the

⁴¹ Ibid.

⁴² Ibid.

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ Ibid.

insured upon occurrence of risk, regardless of the presence of interest in the insured entity. This kind of policy was considered valid and legal⁴⁶ and incorporated terms such as "interest or no interest" and "without further proof of interest than the policy" and "without benefit of salvage to the underwriter" and Policy Proof of Interest, for example.⁴⁷

According to Clark, "Much insurance...did indeed consist of underwriting on purely speculative contingencies such as the outcome of siege, the timing of birth, and especially the longevity of individuals."⁴⁸

As a matter of fact, English courts regularly accepted wagering agreements in the guise of marine insurance so long as this did not give rise to questions regarding breach of public interest⁴⁹. Nevertheless, invested parties were required to express mutual intention of wagering upon conclusion of an insurance policy, and/or to include a declaration such as "interest or no interest"; otherwise, as Algamdi (2006) confirmed, courts would interpret the policy as a contract of indemnity which the insurer would be obliged to indemnify the insured for a real loss. Therefore, the latter party was obligated to declare his interest in the insured subject matter in order to be insured⁵⁰.

⁴⁶ Colinvaux, *Arnould's Law of Marine Insurance and Average*, Vol. I, 1981, para.331.

⁴⁷ Algamdi.E (2006). Supra footnote 9. P34.

⁴⁸Geoffrey Clark, *Betting on lives: The cultural of life insurance in England, 1695-1775*, (1999), p. 3.

⁴⁹ See the argument of Lord Mansfield in *Da Costa v Jones*, (1778) 2 Cowp. 729, 735, ER. 98, 1331; *Good v Elliott* (1790) 3 T.R. 693, ER. 100, 808; *Allen v Hearn* (1785) 1 T. R. 56, ER. 99, 969; *Jones v Randall* (1774) 1 Cowp. 37, 39, ER. 98, 954.

⁵⁰ Algamdi.E (2006). Supra footnote 9. P 35.

2.4 Conventional insurance from an Islamic contract perspective

2.4.1 INTRODUCTION

As previously mentioned, commercial insurance was imported to Arab countries from the west in the 19th century and was viewed as a foreign contract intended/for/by Muslim Arabs. The emergence of the insurance contract in Arab and Muslim countries inspired Islamic scholars and legal experts to pay close attention to this matter. Therefore, this section will focus on the distinctive, but significant attributes of conventional insurance viewed under the gravitas of Islamic scholars. These points include salient features, pillars, principles and a consideration of the Jurisprudential (*Fiqhi*) interpretation of conventional, commercial Insurance, based on the opinions of Islamic, Sharia based scientists.

In the past, it seems that insurance was not legally acceptable, but was instead considered an infringement to laws against usury, constituting both sin and crime⁵¹. Religious concerns universally emphasised the potential for corruption and greed regarding insurance, as noted below:

Muslim scholars have varying views on insurance. Insurance policies that earn interest are generally considered to be a form of *Riba* (usury). Further, some consider policies that do not earn interest to be a form of *gharar* (uncertainty). However, it may be argued that *gharar* is not a salient concept due to the application of actuarial science and underwriting.

Jewish rabbinical scholars have also expressed reservations regarding insurance, considering it "...an avoidance of God's will"; although, most find the idea acceptable in moderation⁵².

Some Christians believe insurance represents a lack of faith⁵³ and there is a long history of resistance to commercial insurance in Anabaptist communities including Mennonites, Amish,

⁵¹ Usury and gambling were prohibited in Islamic Shari'a law rendering insurance contracts invalid. See. El Qora Daghi.A (2006). Supra footnote 22.p134-160.

⁵² [Jewish Association for Business Ethics - Insurance](http://www.jabe.org/insurance.html)". <http://www.jabe.org/insurance.html>. Retrieved 2012-08-06

⁵³ [CIC Insurance - Insurance and the Church](http://www.cic.co.ke/template/t02.php?menuId=72)". <http://www.cic.co.ke/template/t02.php?menuId=72>. Retrieved 2012-08-06.

Brethren in Christ, and Hutterites. However, many of these denominations participate in community-based self-insurance programs to spread out risk within their communities.⁵⁴

Thus, in view of the above, insurance was regularly disguised using an alternative form of contract such as a sale, an exchange or a maritime loan, in order to avoid questions about legitimacy⁵⁵ in relation to the fulfilment of conditions regarding the potential risks befalling lenders. In the 13th century, for instance, some contracts, such as sale or loan contracts, were concluded via insurance formulae known as "commenda"⁵⁶ and "mutuum"^{57 58}.

Historically, separate insurance contracts (i.e., stand alone policies independent of loans or other kinds of contracts) were devised in Genoa in the 14th century, as were insurance pools backed by pledges made against landed estates. These new insurance contracts allowed insurance to be separated from investment. This separation of function first proved useful in marine insurance. Insurance became far more sophisticated in post-Renaissance Europe, when specialised varieties were developed.⁵⁹

Based on historical information, Marshall asserts that, "The law of insurance is considered as a branch of marine law...It is also a branch of the law of merchants, being found in the practice of merchants, which is nearly the same in all the countries where insurance is in use...", thus, "The law of merchants not being founded in the particular institutions, of local customs of any particular country, but consisting of certain principles which general convenience has established to regulate the dealings of merchants with each other in all countries, may be considered as a branch of public law"⁶⁰.

⁵⁴ Rubinkam, Michael (2006). *Amish Reluctantly Accept Donations*. The Washington Post. <http://www.washingtonpost.com/wp-dyn/content/article/2006/10/05/AR2006100501360.html>. Retrieved 2012-08-06. Insurance. *Global Anabaptist Mennonite Encyclopedia Online, Insurance*". Available online at <http://www.gameo.org/encyclopedia/contents/I583ME.html>. Retrieved 2012-08-06.

⁵⁵ For more discussion on the history of usury laws, see, Holdsworth William S, supra footnote 10, p. 100

⁵⁶ "A business association in which one person has responsibility for managing all business property" Garner, *supra*, n 12, at 262.

⁵⁷ "A transaction (sometimes referred to as a bailment) in which goods are delivered, but instead of being returned, are replaced by other goods of the same kind. In common law, such a transaction is regarded as a sale or exchange, and not as a bailment, because these particular goods are not returned." Garner, *supra*, n 12, at 1041.

⁵⁸ Holdsworth William S, supra footnote 10, p 275.

⁵⁹ Algamdi.E (2006). Supra footnote 9. P 30- 32.

⁶⁰ Marshall, *A Treatise on the Law of Insurance*, supra footnote 14, pp. 18, 19.

The Insurance Contract per se, includes principles and features which determined relations between the insurer and the insured namely, reimbursement paid against insurance premiums. Commercial insurance has a considerable range of features, some of which comply with Sharia law, and some which do not.⁶¹

2.4.2 THE DEFINITION OF CONTRACT (AQD) IN ISLAMIC SHARIA LAW.

The Arabic word of Contract “*Aqd*” which means tying or tightening, like “tying rope” or “tightening it”. Thereby, in linguistic uses Arabs used the root verb to derive a noun meaning “firm belief” or “resolution”.⁶²

In Islamic sharia *Aqd* in general recognition is applied to every act which is undertaken in earnestness and with firm determination regardless of whether it emerges from a unilateral intention such as *waqf*, remission of debt, divorce, undertaking an Oath, or it result from mutual agreement such as sale, hire agency and mortgage. *Aqd* in this sense is applied to an obligation irrespective of the fact that the source of this obligation is a unilateral declaration or agreement of tow declarations⁶³.

However, in the specific recognition it has been defined in different ways. The common feature of all definitions is that it is a combination of an offer an acceptance which is gives rise to certain legal consequences.⁶⁴ In Islamic sharia terminology, Kharofa. A (2002) stated that a contract is “the legal bound between the speech of one party to the other’s, in a manner showing the “place”, which is the object of the contract”⁶⁵. Al-Inayah defined it as “a legal

⁶¹ For more details, refer to Abdel Razzakk El Sanhoury (1964), supra footnote 26. El Wasit in Explaining Civil Law, Dar alnahdah alarabia for publishing, (7/1084), Sharaf El Din. A (1983) Insurance Provisions in Law and the Judiciary, Kuwait University Edition, P. 18, El Gammal. G, Commercial Insurance and the Islamic Alternative, Dar El Eatesam Edition, P. 62, Eisa Abdo, Insurance between Permission & Prohibition, Dar El Eatesam Edition, P. 8, Mohamed El Zaabi (1982), Insurance Contracts, PHD from Faculty of Law, Cairo University, P. 164.

⁶² Kharofa. A (2002). *The Loan Contract In the Islamic Law*. International Islamic University Malaysia. first edition 2002. P3

⁶³ Masouri. M (2006). *Islamic Law of Contracts and Business Transactions*. Adam Puplichers & Distributorors, New Delhi, 2006. P20

⁶⁴ Ibid.

⁶⁵ Kharofa. A (2002). *The Loan Contract In the Islamic Law*. International Islamic University Malaysia. first edition 2002. P4

relationship created by the conjunction of two declarations, from which flow legal consequences with regard to the subject matter”, Al-sanhuri. A confirmed “Contract is concurrence of two wills to create an obligation or to shift or to relinquish it”.⁶⁶

Mansouri confirmed that contemporary Muslim scholars prefer the definition of the Al-Inayah referred to the above, because it much more comprehensive, and covers all the ingredients of contract:

- Agreement based on offer and acceptance.
- Contracting parties.
- Completion of offer and acceptance in a legal manner, and
- Subject matter.⁶⁷

2.4.3 BASIC PRINCIPLES AND FEATURES OF ISLAMIC INSURANCE

As mentioned above, emergence of the insurance contract in both Arab and Muslim countries, has prompted Islamic scholars and legal experts to award this issue a high degree of prominence. At this point, the distinctive features of Asian, European and Islamic insurance contracts, formed by respective financial governing bodies (e.g. the SAFSA and FSA), are detailed below. However, as previously stated, some conform to Sharia law and some do not; thereby establishing good reason for Islamic scholars to jurisprudentially study insurance contracts and their effects.

- **Insurance as an obligatory contract**

An insurance contract is considered an obligatory agreement binding both parties upon completion of legal procedures. In short, neither party may break their contractual obligations. This means that the insured is duly obligated to pay an agreed premium to the insurer, on

⁶⁶ Masouri. M (2006). *Islamic Law of Contracts and Business Transactions*. supra footnote .P21.

⁶⁷ Ibid. P22.

contractually specified dates, and commits the insurer to pay the agreed amount upon occurrence of the insured incident⁶⁸.

Thunayan (1993) has criticised this, asserting that these two commitments are not equal. To explain, the insured commits to pay a fixed premium on a fixed date based on an indefinite possibility. This possibility is certain neither in time, nor in amount/cost. Regardless of this, he/she is obligated to pay the agreed amount on time. On the other hand, as opposed to being fixed, the insurers' commitment is merely probable regarding time and amount, since the incident may, or may not, occur. Here, the insurer must pay the whole amount if an incident wholly occurs, part of the amount if the incident partly occurs and, in cases where the incident does not occur, he/she/they will pay nothing at all. Also, in terms of time probability, if the incident occurs and the insurer is uncertain of the time of occurrence, insurer obligation becomes unclear thereby affecting validity according to Islamic Sharia rules⁶⁹.

However, Contracts in Islamic Sharia law vary. For example, some contracts are optional to fulfil, such as the *Mudarabah* contract, and some are obligatory⁷⁰.

- **Insurance; a contract regarding financial reimbursement.**

The Financial Reimbursement Agreement represents a contract in which either party takes a return against what he gives. Further to this, in Islamic Sharia law, a contract of sale must be free from the qualities of gambling, interest (*Riba*), uncertainty (*Gharar*) and ignorance (*Jahalah*)⁷¹. This contradicts any contract based on donation/charity transaction in which one party gives to the other without return. Thus, the Insurance contract is considered a reimbursement agreement, where the insurer, or the insured, takes a return against premiums, and the insurer takes a return against what he commits to pay. What is more, the insured gain a return against premiums towards insurance maturity, if and when conditions are fulfilled.

⁶⁸ In the event that either party decides to cancel the agreement however, for practical reasons, today's insurance companies often state that the insurer is entitled to cancel the policy after notifying the other party within a certain period. Also, the insured is entitled to terminate his/her insurance policy with the insurer after notifying the other party within a certain period and paying the due amounts⁶⁸. See Lloyds TSB insurance available online on: http://www.lloydstsb.com/insurance/car/car_insurance.asp

⁶⁹ Al Thanayan. S (1993), *Insurance & its Provisions*, Dar ibn Hazim for publishing, Edition 2003, Beirut, P. 91-92.

⁷⁰ For further information, see Ibn qudamah (1223AC)(620H). *Almugnee*, Dar al kutub for publishing, edition 3, 1997, Beirut. V 6.

⁷¹ Melhem. A (2002) *Islamic Insurance*, Dar Almaarifah for publishing, P. 30

- **Insurance; a time contract**

El Qora Daghi (2006) asserts that insurance is a time measured contract in which time is a basic element. To illustrate, the insurer is committed to incur the insured dangers, over a specific period, as of a certain date⁷². Therefore, the obligations of either party begin at a specific hour upon the date of commencement. Conversely, the contract ends at a specific hour upon the date of contract termination. During this period, the contract is considered continuous; thus legal experts have labelled it a continuity contract.

What does this mean? Basically, that if the contract is cancelled either by both parties or by one, it shall be deemed irrevocable, i.e. the insured will lose the right to redeem any paid premium, whatever the amount. Also, in cases where the commitment of any party is negated, such as if the insured property is damaged under circumstances other than those it is insured against; the contract will be cancelled and the insured shall lose the right to redeem any paid premium⁷³. This feature has prompted Islamic scholars to pay close attention regarding the outcomes of insurance contracts.

- **Insurance is a civil contract**

El Qora Daghi (2006) asserts that insurance is, in essence, a civil contract, that may become a commercial contract where an insurance company takes the form of a joint stock company based on the principles of commercial insurance, i.e. via fixed premium. In this instance, all business activities would be considered commercial. However, cooperative insurance companies tend not to be considered commercial because they are non-profit making and are not joint stock companies.

However, some laws do not differentiate between insurance types, whether commercial or cooperative. El Qora Daghi (2006) points out that Kuwaiti trade law stipulates, in article 5/9, that “all kinds of insurance are considered commercial”⁷⁴. The onus of differentiating “civil”

⁷² El Qora Daghi. A (2006). Supra footnote 22. P. 18

⁷³ Thunayan. S (1993) supra footnote 50, P. 91-92, Abdel Razzak Farag (1962). *Insurance Contract*, Damascus University Edition, P. 120-121.

⁷⁴ Thunayan. S , Ibid.

from “commercial” belongs to the presiding authority and judiciary in terms of claims and procedures.

- **Insurance as a submission contract**

El Sanhoury (1964) defines the submission agreement as a contract in which the dominant party alone possesses the right to set contract conditions, and the opposing party must accept or reject these conditions as a whole⁷⁵.

So, submission is a contract founded on the basis of “take it, or leave it”. Melhem (2006) argues that the dominant party in this contract is the insurance company, as it sets contractual conditions that the insured must accept if he/she desires the insurance. Much of these conditions are pre-printed and some are oppressive, harming the insured persons’ interests⁷⁶.

A number of countries have intervened to limit oppression and grievance triggered by these conditions thereby, protecting their citizens. Indeed, in Egyptian law, the legislator sets restrictions for protecting the weaker party via controlling legislation, regulating the law and regulating the interpretation of text within contracts, so as doubt is interpreted in favour of the insured, although he/she is the debtor. For instance, article 753 (based on civil law), declares that “each agreement, violating provisions stipulated in this chapter, is null and void, unless it is in favour of the insured or the beneficiary”. This article is upheld by the Egyptian Court of Cassation⁷⁷.

- **Insurance as a probable contract**

The term probable contract signifies that both contractors are unaware of the amount of loss incurred. This, in Islamic Sharia law, establishes an element of contractual uncertainty (*Gharar*) and ignorance (*Jahalah*).

⁷⁵ El Sanhoury. A (1964), Supra 26, Part 2, P. 1176-1177

⁷⁶ Melhem. A (2002), Islamic Insurance, supra footnote 52, P. 31.

⁷⁷ El Qora Daghi. A (2006). Supra footnote 22, P. 20.

Melhem (2006) explains that here, the insurer, and the insured, remain unaware in terms of factors such as the time taken to set up the contract, the amount taken or the amount paid, as this depends on the occurrence, or non-occurrence, of the insured danger. He confirms that uncertainty (*Gharar*) present in this type of contract is the most severe since it is not included in the compensation amount, but instead the amount is obtained upon maturity⁷⁸. Therefore, legislators consider insurance contracts to be *Gharar* contracts, which include gambling and mortgages⁷⁹.

- **Insurance is a contract based on utmost good faith:**

The principle of good faith originates from the general principles applied to all contracts. The insurance contract is distinct from other contracts as good faith plays a pivotal role, potentially affecting the conclusion more than is the case in any other contract. Therefore, the insurer, in approving data provided by the insured, adopts the principle of good faith, as he must take, on good faith, the insured persons account of data. This doctrine is also applied while setting up and implementing the contract⁸⁰.

Furthermore, section 17 of the Marine Insurance Act (MIA) 1906 specified the general principles of good faith for inclusion in the insurance contract: “The MIA contract is a contract based upon utmost good faith and, if this principle is not observed by either party, the contract may be voided by the other party.”⁸¹

2.4.4 PILLARS OF THE INSURANCE CONTRACT FROM AN ISLAMIC PERSPECTIVE

Islamic experts usually use a distinctive method of analysis when addressing an important topic, i.e. the insurance contract, by establishing a core base constructed of three main pillars. In order to aid readers understanding, a description regarding the core content of these pillars is given below. These pillars were the outcome when Islamic scholars and economists dealt with insurance as a new matter.

⁷⁸ Melhem. A (2002), *Islamic Insurance*, supra footnote 52., P.30

⁷⁹ El Sanhoury. A (1964), *Supra footnote 26,V 7*. P1140

⁸⁰ Sharaf El Din. A (1983), *Supra footnote 48*, P. 118

⁸¹ Peter .M .Eggers (2004) *Good Faith and Insurance Contracts*. London Singapore, second edition, p33

Islamic Insurance contract consists of:

1. Contracting parties.
2. Contract wording.
3. Contract subject matter (*Mahalul-Aqad*), which consists of:
 - A. Risk.
 - B. Premium.
 - C. Amount of the insurance (the compensation).

1. The contracting parties

The two parties are the insurer (the company), the insured (including the insurance applicant), mutually obligated to meet the requirements of financial contracts including capacity of payment. In commercial insurance, the insurer is the company, while in co-operative mutual Insurance, the insurer is the Society and in current Islamic insurance, the insurer is the insurance account, subscribers' group or insurance fund.

Any Islamic corporate licensed insurance, acts as an agent for such an account whereas, the insured are either individual people or corporate bodies.

However, El Qora Daghi (2006) adds that there are a number of mediators between contracting parties such as: Authorized Agents, Delegates with General Power of Attorney and Brokers. The authority of each may vary according to their respective capacity:

An Authorized Agent has the broadest authority where he is entitled to directly enter into contract with customers on behalf of the insured person. He also has the right to modify the contract, receive premiums and settle compensation⁸².

On the other hand, a Delegate with a General Power of Attorney is responsible for signing the most advantageous contract in terms of general insurance, but has no right of amendment or addition therein⁸³.

⁸²El Qora Daghi. A (2006). Supra footnote 22. P 32.

A broker has the narrowest level of authority; however, this may expand depending on conditions determining a specific task, such as the mediation of contracts otherwise impermissible for brokers to surmount. This is normally the case where the authority of agents has not been clearly defined. Further, a broker has some powers regarding the implementation of a contract, as well as receiving premiums and payable compensation⁸⁴.

- The validity of both parties' consent:

Whenever we state the term two parties, we mean both insurance companies and the insured person. There appears to be no fundamental difference between Islamic law and other laws, in this regard. Billah (2007) stated that the parties to an insurance policy under Islamic law are the same as those in an insurance policy under Common law⁸⁵.

As for a company's valid consent, whether a joint stock company or a mutual cooperative, it is not the place to talk about capacity due to the availability of legal requirements and legal personality, as it is represented by the authorised signatory on behalf of the Board of Directors.

Matters are different concerning the insured party. For example, in Egyptian civil law, as far as "El Sanhoury" is concerned, there should be clauses for mental capacity including the capacity to administrate, as well as the verification of legal age and adulthood.

In relation to minors, it is impermissible for a young person to draw up an insurance contract unless he/she is authorised to trade and form contracts by his/her guardian (*Alwali*). If she/he does not obtain consent, then the contract will be void unless later approved by a guardian or conceded whenever she/he reaches mature mind (*Alrushud*)⁸⁶.

⁸³Ibid.

⁸⁴ Ibid.

⁸⁵ Ma'sum Billah. M (2007) stated that the parties to an insurance policy under Islamic law are the same as those in an insurance policy under the Common law.

⁸⁶ Alsanhoury. supra footnote 26. P1146.

Nevertheless, according to Islamic *Fiqhi* schools, the Hanafi, Shafae and Hanbali assert that the age of mature of mind (*Alrushud*), is 15; whereas, in maliki schools, the age is 17 regardless of gender⁸⁷.

In Malaysia (2007), the Islamic *Fiqhi* Academy, confirmed that the age of a discerning minor (*Tameez*) is 7 years (decision no (168(18/6)). Also, the age of mature mind is 15 for worship purposes, however, in terms of a financial and criminal onus, the legal authority has the right to determine appropriate age according to place and environmental conditions⁸⁸.

In Islamic law, acts regarding minors are fairly concordant, as both the Hanafi and Maliki divide statutes, relating to minor's, as follows:

- A purely beneficial act, which is useful to him/her such as accepting the gift and embracing Islam so it becomes possible to give, and take, endlessly with no need for permission or to ask why.
- A purely harmful act such as lending money, or taking out loans, is void even with the guardian's permission.
- An act which ranges between benefit and harm, like selling and buying, is held and suspended until receiving final permission from competent authorities.

However, The Hanbali School stipulates that the acts of a sane minor are valid with the permission of a guardian (*Wali*), and null and void without this permission. Contrary to this, the Shafae's do not validate the act of a minor, even if his/her guardian allows.

Scholars, in all four schools, agreed upon the fact that a guardian should guarantee a minor's damages regardless of whether those damages concern life injuries or money⁸⁹.

Through jurisprudential and legal analysis relating to the validity of consent by contracted parties, it is worthwhile noting that the contract of insurance is different from other contracts. In other words, an insurance contract is not primarily profitable, but is held for safety against

⁸⁷ Alzohaily. Wahbah. *Alfiqh alaislami waadelatoh*. Dar alfikr for publishing, edition 33 (2011). V 5, p 415

⁸⁸ Islamic Fiqhi Academy. Conference no 18 (2007) Malaysia. Available online : <http://www.fiqhacademy.org.sa/Malaysia-q18.pdf>. Retrieved on 13- 08 2012

⁸⁹ See Alzohaily. Supra footnote 80. V5. P 415 - 420. Albahooty. *Kashaf Algenaa*. almaktabbah al-islamiah for publishing, edition D.T. (1982). Beruit v3.p431. Ibn qudamah (1223AC)(620H). *Almugnee*. Supra footnote 51. V4, p457.

unexpected damages. No one is immune to the unexpected occurrence of risk, whether a sane adult, a young person or even a child in the womb.

Thus, lifelong participation in an insurance contract is best considered, not only in terms of the nature of the contract, but also with regard to unexpected risk. Therefore, in order to ensure that the object of insurance conforms to Islamic Sharia provisions via the application of mutual insurance against risk, Billah (2007) proposed four-appropriate paths of equitable opportunity for all members of society, providing protection from any unexpected damage:

- a) Upon reaching the age of 15 i.e. the age of commissioning - as far as the majority of scholars are concerned - young people must be treated like adults in terms of their signature, acknowledgment of contract and obligation.
- b) A person under the age of 15 years has the right to obtain insurance and to give his/her name, but does not have the right to sign, although this may be possible pending the approval of a guardian.
- c) A young child also has the right to insurance, obtained on his/her behalf although the guardian who purchased the policy must have full control of the document.
- d) The foetus has the right to insurance from the time it is created and, as there are many risks on its life, his/her guardian purchases a policy in the interest of the foetus against any medical risks that might be expected.⁹⁰

The above may be seen as an overreaction regarding the rights of the foetus, who is in receipt of medical supervision, belongs to his/her mother and is dependent upon her for nutritional and health stability. Therefore, how do we separate mother and foetus within the insurance contract, since a foetus has no legally recognised personality to be trusted, and in Islamic law, regarding *Zakat al-Fitr*⁹¹, financial donation has been obligatory for male and female, young and old, master and slave. In this respect, financial cover is not prescribed for the foetus, although guidance is provided in view of options, rather than obligations. If she/he had been awarded the legal status of an independent legal character, financial contribution would have

⁹⁰ Ma'sum Billah. M (2007). Supra foot note 3.

⁹¹ Alzohaily. Wahbah. *Alfiqh alaislami waadelatoh*. Ibid

been obligatory. In addition to compensation, in Islamic jurisprudence, a foetus' blood money must be paid (10/1) tenfold a woman's blood money⁹².

However, El Qora Daghi (2006) has pointed out that consent is required to secure the validity of an insurance contract, and this must not contain any defect of consent, such as coercion, fraud or even a simple mistake in data presentation⁹³.

⁹² Albahooty. *Kashaf Algenaa*. *Supra footnote 67*. V 3, p220.

⁹³ El Qora Daghi. A (2006). *Supra footnote 22*, p. 35.

2. The wording of the contract

A written contract governs the relationship between parties in terms of duties, rights, obligations, terms and exceptions, together with implementation and reporting. It is a customary convention among the insurance companies that contracting must be concluded through an insurance policy written and signed by contracting parties⁹⁴.

Nowadays, insurance companies tend to conclude the contract through a recorded call or via the Internet. The insured is given the number of their insurance policy as a sort of evidence that insurance cover is proved from the date and time of call, provided the original document is sent later, by mail⁹⁵.

In the Gulf societies, El Qora Daghi (2006) points out that the practice among insurance companies has been that a contract is not concluded upon reaching a verbal agreement, but via the insurance policy, signed by its parties⁹⁶.

In Islamic law, commercial contracts are based on acceptance and offer and therefore, El Qora Daghi (2000) states that this type of acceptance does not mean that the insurance contract is not a formal one since contracts do not depend upon writing only. Instead, writing is merely a means to prove, rather than to conclude an agreement. In this respect, the author confirms that acceptance and offering are the bases behind any insurance contract⁹⁷.

Article 1048 of the preliminary draft of Egyptian Civil Law states that the insurance contract does not come into force unless both parties sign the insurance policy. At this point, the policy is accordingly handed over to the insured party. This process clearly indicates that the insurance contract is a formality which is not binding unless the insured party receives a copy of the document with his/her own signature. However, this article was cancelled by the Audit Committee⁹⁸.

⁹⁴ Ibid.

⁹⁵ Aviv Insurance Company. Available online on: <http://www.aviva.co.uk>

⁹⁶ El Qora Daghi. A (2006). Supra footnote 22, p 40.

⁹⁷ Ibid.

⁹⁸ Alsanhoury. *Alwaseet*. Supra 26.v7.p1174

Sharaf al-Din (1983) confirms that the contract of insurance is basically a consensual, and not a formal, agreement. Here, the right of each party to agree to make an official contract is held only after being written and signed by both parties to give rise to legal effects⁹⁹.

3. Contract subject matter (Mahalul-Aqad) which consists of;

Insured risk

Risk is the most important element in insurance as it epitomises the obligation undertaken by both the insurer and the insured. The insured party undertakes to pay premiums in return for reducing the effects of risk, and the insurer undertakes to pay an amount of insurance to secure the insured from the effects of risk. Risk results from the premiums and the amount of insurance as well as the measurement of both.

However, the risk in relation to insurance can be defined as (any probable accident, which is unpreventable as per the will of either party, and especially the will of the insured)¹⁰⁰.

An insured risk should meet several conditions;

Islamic legal experts stipulate certain conditions in order to make an insurance contract valid:

1. That the risk must be potential. For instance, potential risk is demonstrated in the two following forms:
 - a. Insurance from theft or fire is a risk that may or may not happen.
 - b. An insured event may be inevitable and yet, on the other hand, it may present a potential risk, where time is non-specific, such as life insurance; death is inevitable, but time is unknown.

In view of this analysis, the legal impact in cases where risk is unfeasible, thereby rendering the subject matter impossible to insure, means the contract will be null and void. For example, if a person insured his/her house against fire damage then made sure, before entering into this agreement, that the house had been destroyed, such an insurance contract would be void due to

⁹⁹ Sharaf El Din. A (1983), Supra footnote 48. p 120

¹⁰⁰ Albadrawi. A.(1963). *The Insurance*. Wahbah Publisher. Cairo.p61. Alsalih. M(2004)*Insurance between permission and prohibition*. Al-Obiakan publisher.Riyadh.p 65

the lack of a building as well as the realisation of risk (the subject matter) in favour of the insured. To give another example, if someone insured his/her house against fire and the house burned down at time of contract, the insured parties risk has already been realised and so, the contract is null and void. This is due to occurrence of risk and lack of probability, in favour of the insurer.

To summarise; if risk is unfeasible, as is the case in the first example (there is no risk because there is no house), or lacks probability as is the case in the second, then the insurance contract is considered both null and void¹⁰¹.

Risk in relation to the absolute will of both parties.

Insurance is based on events that are likely to happen, and whether the risk is relevant to the will of either party. In this instance, possibility is equal to risk subject to the will of that party and thus an element of risk is reduced. The contract of insurance is considered null and void as per Article 768/2 of the Egyptian Civil Code (either loss or damage caused by the insured intentionally, or by fraud, the insurer shall not be responsible, even where other issues have been agreed upon)¹⁰².

Under The National Company of Cooperative Insurance NCCI “*Al Tawuniya*”, article 6, the general conditions of insurance also cover personal accident insurance, stating that, in cases of “fraud, concealment and/or, intentionally giving false statements, whether in the application, upon which the insurance is made, or with regard to something else affecting this insurance, or the provision of any claim which may lead to the cancellation and annulment of such insurance, results in the forfeiture of all claims thereof”¹⁰³.

Thus, it is not permissible for any person to insure himself for his intentional action, because the intentional act is related to his own will, and if the insurer has insured his life and then terminates that life for example, his contract shall not be worth the agreed amount of insurance or compensation since he intentionally incurred risk, via death.

¹⁰¹ Alsanhoury. *Alwaseet*.supra 26. V7.p1218

¹⁰² Ibid. v 7. P1176

¹⁰³ Al Tawuniya Insurance Company. Saudi Arabia available online on: <http://www.tawuniya.com.sa/>

An insured risk should be legitimate

In other words, insured risk should not violate public law and order. At this point, article 749 of Egyptian law states that, provided it has been the subject of insurance, every legitimate economic benefit should be returned to a person as a result of the non-occurrence of risk”¹⁰⁴. Therefore, insurance may not be legitimate in terms of risks resulting from drug trafficking for instance.

As far as the Islamic Sharia is concerned, every illegal matter is uninsurable. To illustrate, the first article of the Law On Supervision of Cooperative Insurance Companies in Saudi Arabia declares there should be....“ no contradiction with Islamic Sharia....”¹⁰⁵, therefore, it is not permissible to carry out insurance on usury-based transactions or prohibited products and trade in Islamic sharia such as the sale of alcohol or prostitution and so on.

The Premium

The premium in commercial insurance is the amount of participation in cooperative insurance and Islamic insurance. This premium is intended to settle the amount paid by the insured to the insurer, or to any cooperative society or the account of insurance, whether in the form of instalments or all at once. The premium is the mainstay of insurance, which is not less important than risk. This payment/participation represents the main obligation of the insured in the insurance contract.

Determining the amount of a premium depends on several factors such as¹⁰⁶:

1. Risk Factor:

Which intervene in determining the value of the premium is as follows:

¹⁰⁴ Alsanhoury. *Alwaseet*.supra.v7.p1218

¹⁰⁵ SAMA. The Law On Supervision of Cooperative Insurance Companies in Saudi Arabia. Article 1. Available online : <http://www.sama.gov.sa/sites/samaen/Insurance/Pages/LawsandRegulations.aspx>. Retrieved on 13-08-2012

¹⁰⁶ Alsalih. M(2004). Supra footnote75. p 65. El Qora Daghi.A (2006), Supra footnote 22. Alnajar. A (1994).*The insurance contract in Islamic Sharia*. Dar alnahadah alarabia for puplishing.Cairo. p 50.

- a. Degree of probability of risk is based on probabilities, actuarial science, tables of statistics for previous incidents and proportion of expenditure set against the proportion of shareholders.
- b. Degree/gravity of risk when it is realised within the observed time and place, in context of surrounding circumstances.
- c. The principles of proportionality regarding risks and premiums in kind and name.
- d. Risk data provided by the insured party.

2. The Insured Amount

The insured amount has a role in determining the premium, or the amount of subscription, especially in terms of insurance for individuals and life insurance. At this stage, if the insured amount has increased, the premium increases. In fact, premiums often increase in accordance with increases in the amount of insurance rates being calculated.

3. The Period of Insurance

Because time has a role in determining the premium, whilst insurance contracts have long been considered as time contracts, so premiums should be measured by units of time. If the period of contract increases for more than one year, the premium amount also increases; if it is agreed that the premium is to be paid monthly, this does not mean that the base unit of time to determine the premium is a month. Hence, although the year remains the main unit of measurement, this is solely as a means to pay out the premium and not to determine it.

The amount of insurance or (the Compensation)

Compensation refers to the obligation of the insurer to pay the amount accrued at the time of insured risk, where the object of this obligation is the insurance amount. Sometimes the obligation is conditional, based on the fact that the insured risk is potential, as in vehicle or fire insurance for example. Sometimes compensation is attached to a fixed date upon condition that the insured event is realised, although the insured party may not know properly if this arrangement has come to fruition, as in the case of death insurance¹⁰⁷.

Al Saleh (2004) considers that the insurance total is a debt of the insurer; this debt may be attached to a non-specific date, as with life insurance in the event of death; whereas, for death

¹⁰⁷El qora Daghi. A (2006), Islamic Insurance. Supra footnote 22. P65

insurance, the date is unknown. The debt may be potential as in fire or liability insurance, because the insured risk is uncertain, and so the amount of insurance is a potential debt due to the possibility of potential risk¹⁰⁸.

This could be the case with regard to having the effect of an insurance contract on the insured which is equal to the sum of the insurance. But looking at the original insurance contract, it seems clear this cannot be classed as a debt contract, rather it is an exchange contract where a premium is paid in return for safety. This indicates that if the specified period in the contract was terminated, and there was no risk, the insured party would not be entitled to claim a refund for the premium paid previously.

The Modes of Payment regarding Compensation are as follows:

- A. Compensation should be paid in cash when the object of payment is an amount of money.
- B. Damages may be paid in kind, as with some types of insurance where the insured retains for him-self the right to choose a mode of payment, albeit in cash, kind or in repairing damage to bring an item back to its condition prior to the accident.
- C. Payment can also be in the form of provision of personal services, as is the case in liability insurance, where the insurer retains the right to intervene in any lawsuit brought against the insured¹⁰⁹.

According to Al Saleh (2004) it differs to determine this obligation whether we are ahead to insure injuries or persons' insurance¹¹⁰:

1. The Obligation of the Insurer in terms of Personal Insurance:

The obligation of the insurer concerning insurance for private individuals often determines the agreed amount in an insurance policy. Private insurance does not aim to compensate for injury resulting from death or accident, but instead aims to alleviate injury. So, regardless of value, personal insurance does not guarantee compensation for all damages resulting from accident

¹⁰⁸ Alsalih. M(2004)*Insurance between permission and prohibition*. Supra footnote 75. p77

¹⁰⁹ El qora Daghi. A (2006), *Islamic Insurance*. Supra footnote 22. Ahmed Sharaf El Din (1983), Supra footnote 48. p 232

¹¹⁰ Alsalih. M(2004). Supra footnote 75.

or resulting in death. The insured amount merely determines the sum of obligation on the part of the insurer where there is no correlation between the obligation and the injury.

Personal insurance is aimed at taking precautions for the future, and if required, the insurer must pay the sum of insurance to the insured if he/she is still alive on the agreed date. Therefore, no harm is incurred when choosing personal insurance, as a basis for compensation.

2. The Obligation of the Insurer in Insuring Damages.

The obligation of the insurer in insuring damages is governed by the principle of compensation. Hence, any insurance against damages is considered a contract of exchange. Here, several elements are involved in determining the obligation of the insurer with regard to damage insurance:

A. The Occurrence of Damage

Damage is the main component in determining the obligation of the insurer, since there is no compensation without damage. An insured accident may have taken place, but unless damage has occurred, the insured is not entitled to compensation. In the event of damage, the insured should confirm/prove the degree of damage inflicted upon him, as the extent of damage determines the level of compensation, unless the damage is equal to less than the insured amount. Thus, the insured party is entitled to receive the equivalent compensation for the damage incurred. In other words, incurred damage is worth the least of two amounts (the amount of insurance or the amount of compensation).

B. Insured Amount

This is the amount agreed upon in the insurance policy, and is a basis for fixing premium payments. The insured amount is often equal to the value of the insured matter. In cases of liability insurance, parties determine a maximum not exceeding the responsibility of the insurer.

C. The Value of the Insured Matter

If the insured matter is totally destroyed, to the point where the insurer is fully committed to the insured for compensation, insurer obligation is determined by the value of the insured matter at the time of the incident and within the limitations of the insured amount as follows:

1. If the value of the insured matter is equal to the insurance amount, the insured receives an amount equal to the cost of all damage inflicted upon him.

2. If the insured amount exceeds the value of the insured matter (this form is called the overcharge or over insurance¹¹¹) in this case, it is not allowed to increase the amount of compensation for the value of the insured at the time of actual risk and pursuant to compensatory status.
3. If the insured amount is less than the value of the insured matter at the time of risk, it shall not exceed the amount paid to the insured for the agreed sum of compensation, no matter the amount of damage (this form is called under insurance¹¹²)¹¹³.

¹¹¹ For more about over insurance see *Dictionary of Insurance Terms*, 5th edition, by Harvey W. Rubin, Ph.D., CLU, CPCU, published by Barron's Educational Series, Inc. Available online at : <http://www.answers.com/topic/overinsurance> . Retrieved on 11-08-2012.

¹¹² For more about under insurance see Insuropedia webpage. Available online at: <http://www.insuropedia.com/UnderinsuranceClauseBusinessInterruption> . Retrieved on 11-08-2012.

¹¹³ Alsalih. Ibid

2.5 An Islamic Jurisprudential analysis of the Commercial Insurance

2.5.1 INSURANCE AS AN IDEA OR THEORY VIS-À-VIS INSURANCE REGULATION OF EXISTING CONTRACTS

Insurance is theoretically acceptable to the Islamic concept, therefore, Al Sanhoury (1964), stresses that insurance is not only an organised co-operation between a group of people to pay for risks, it is also subdivided so that if someone faces risk, everyone co-operates to face it together. With little sacrifice exerted by all, the group can avoid the severe risks and damages that would have beset them without this co-operation¹¹⁴.

Al Zarqa (1980) adds that the concept that lies in the minds of legal scholars concerning the insurance system is that it is a system of cooperative solidarity which leads to fragmentation of risks and calamities, via distributing them among groups of insured persons. Therefore, compensation is paid to the injured from the proceeds of premiums, instead of this damage being the responsibility of the injured alone. It is often said that Islam with its legislations concerning the organisation of social and economic life, aims to establish a society based on co-operation and absolute solidarity in terms of rights and duties¹¹⁵.

On this basis, there is no doubt that the above idea is acceptable in Islamic law and is consistent with the purposes of the law. For example, to co-operate in good faith, is an Islamic feature underpinning most of the provisions of Sharia, as it calls for co-operation and social solidarity. Furthermore, Islam has enjoined *Zakat*¹¹⁶ and has formed a system for the deserved poor, debtors, and the wayfarer to be within the lines of expenditure thereby promoting financial protection. Also the system of expenditure regarding relatives, the system of ransoms “*Alaaqlah*”¹¹⁷, and the duty of the State combine to provide a proper life for

¹¹⁴ Alsanhoury. *Alwaseet*.supra 26. V7.p1218

¹¹⁵ Alzarqa.M (1980).*The insurance system and Islamic Shari'a*. Islamic Economic book. Development conference in Damascus.p279. Alhamid.H.*The verdict of Shari'a on Insurance*. Dar Alitsam. Cairo.p16

¹¹⁶ Obligated charity which is 2.5 % of person's wealth.

¹¹⁷ *Alaaqlah* are the male factions of a tribe whom relevant to the killer from his father's side. Here, Arab traditions advocate that, in the case of murder, the *Alaaqlah* collect blood money (*Diyah*) from each of the tribe's males to be paid to the victim's family. See,Almirdawy.A(1480) *Alinsaf*. Ministry of Islamic affairs, Saudi Arabia. Volume 26, p50

individuals and assume the task to pay debts for individuals in cases where an individual has died and left nothing to creditors.

However, from an Islamic law perspective, the problem with the applied aspect of insurance is represented in the drafting of contracts, in light of capitalist thought, which does not observe religious aspects, and aims to profit in any way possible. This may lead us to accept the ideas mentioned before, as well as to change these types of contracts to observe the principles and concepts of Islamic law, taking into account projects such as profitable businesses.

2.5.2 JURISPRUDENTIAL ANALYSIS OF THE RULES OF COMMERCIAL INSURANCE

2.5.2.1 Introduction:

The idea of insurance, in terms of legitimacy and acceptability has triggered much debate amongst the scholars of Islamic law. However, the current draft of contracts includes certain elements such as usury, uncertainty, gambling which do not observe the principles of Sharia, and in fact, contradict them.

The Islamic Sharia is based on the lawfulness of any issue, as confirmed by El Qora Daghi (2006) including the legality of subjects, means and objects. An issue may be legitimate in principle, but may still be unsuitable if in contravention of these laws. For example, a trade may be permissible, but if it contains usury, it is prohibited. Thus, no matter how legitimate and useful the idea, it cannot be validated unless it is formulated via a legitimate contract and does not contravene Islamic law.¹¹⁸

On the other hand, those who indicate that insurance is permissible in Islamic Sharia law do not state that usury or gambling are permissible, but instead argue that such elements do not exist within the contract. Therefore, the dispute between scholars of Islamic law is focused on the presence of such elements rather than on rulings/outcomes.

Al Zarqa (1980) states that in principle, there are no objections to making a profit through insurance, but if insurance transactions between insurance companies practice usury, then

¹¹⁸ El- Qora Daghi. A (2006), Islamic Insurance. Supra footnote 22.

these conditions can be judged on the basis of prohibited practices and potentially, corruption.¹¹⁹

2.5.2.2 Jurisprudential contradiction of rules of insurance

There is contradiction amongst the contemporary scholars of Islamic Sharia in terms of opinion regarding the rules of traditional commercial insurance, these have been divided into two groups as detailed below:

1. A group that views commercial insurance as unlawful.
2. A group that views commercial insurance as permissible.

2.5.2.2.1 The opinion that commercial insurance is unlawful

The school that views commercial insurance as unlawful bases this opinion upon four forbidden elements, as per the Islamic Sharia, i.e.: uncertainty, gambling, interest and taking money unjustly.

This point will be considered in detail in accordance with the judgments of Islamic jurisprudence schools:

- **Uncertainty:**

Here, opinion is based upon the accounts of the following *Sunna* witnesses (Hadith):

Abu Huraira (Allah be pleased with him) reported that Allah's Messenger (May peace be upon him) forbade a transaction determined by throwing stones, and the type which involves some uncertainty¹²⁰.

This Hadith is essential for transactions and is based in financial exchange contracts.

¹¹⁹ Alzarqa.M (1980).*The insurance system and Islamic Sharia*. Supra footnote 88.

¹²⁰ Imam Muslim. *Sahih Muslim* translated by Abdul Hamid Siddiqui. *The Book of Transactions (Kitab Al-Buyu')* available online <http://www.usc.edu/schools/college/crcc/engagement/resources/texts/muslim/hadith/muslim/>

Definition of Uncertainty:

Uncertainty is deemed as one of the most influential elements in insurance rule by Sharia scholars. The scholars of Islamic Sharia -divided into four schools- may not differ a lot in defining Uncertainty, whereas Al-Zailaa'i (1313 H¹²¹.) - A Hanafi Scholar- defined uncertainty as "Transactions with unknown consequences, where participants are unsure whether a point will, or will not be achieved"¹²².

In respect of the Maliki School, Bin Arafa (1329 H.) has defined uncertainty as "The transaction that in doubt in achievement- some or most - by any of its offset"¹²³. In regard to the Shafi'a school, Al-Rafa'ee (623 H.) said that "it is the transaction which result may be unknown to the person"¹²⁴, while Algadi Abu Yalaa (380H) from the Hanbali School defined it as "the transaction that hesitating between two things, one of them is not apparent"¹²⁵.

So, by way of the aforementioned definitions, presented by the scholars of Islamic jurisprudence schools, the reader may discover that the meanings of uncertainty are convergent.

In further jurisprudential analysis concerning uncertainty and the commercial insurance contract, Al-Qora Daghi (2006) has stated that uncertainty is influential in relation to financial indemnification contracts. According to the consensus of scholars, the most important forms of uncertainty are as follows¹²⁶:

a. Uncertainty in the Existence of Risk throughout the Insurance Process:

The insurance process involves uncertainty in the existence of risk. However, it is the subject matter (*Mahalul-Aqad*) identified in the contract which is potentially at risk. Hence, this danger is probable and unconfirmed. Yet, jurisprudence scholars have not been in conflict

¹²¹ H means a *Hijrah* calendar which represents the Islamic calendar.

¹²² Al-Zailaa'i Fakhru'ddeen. (1313 H.) *tabeen alhagaegwasharh alkanz*. Omar bakashab for Publishing. Cairo.

¹²³ Albodory. Y(1329H). *Altaj walekleel*. Dar alsaadah for Publishing. Cairo.

¹²⁴ Al-Rafa'ee. A (623 H.). *Fateh-u-alziz*. Sharekat-u- aluamaa for Publishing. Cairo

¹²⁵ Algadi Abu Yalaa (380H). *Matalib oly alnohaa*. The Islamic office edition. Damascus. V3.p25

¹²⁶ El qora Daghi. A (2006), Islamic Insurance. Supra footnote 22.

regarding the influence of risk upon nullification of contract. Therefore, as we can see, the amount of insurance previously negotiated with a company, is not guaranteed since it depends on the existence of the insured risk, once the risk takes place the amount shall be due. Conversely, if this event does not take place, nothing will be paid out. Indeed, legislators do not deny this fact, thus, Egyptian Civil Law categorises this insurance contract amongst those characterised by uncertainty¹²⁷.

b. Uncertainty in Obtaining Compensation

Basically, this means that the subject of the contract is, in itself the risk. Thus, in spite of its existence, the possibility of indemnification remains merely probable. This is because, at the time of agreement, whether appropriate compensation will be paid out against premiums, remains unknown. Therefore, entering into an agreement is a risk when attempting to obtain compensation.

As mentioned above, Scholars are all in accord concerning this identified uncertainty as it nullifies the contract of reimbursement.

c. Uncertainty regarding the Amount of Compensation:

Agreed sum is considered to be one of the basic conditions in a contract of sale and reimbursement. As far as Islamic Sharia scholars are concerned, the amount of compensation is to be known at the time of wording the contract.

Ibn Abideen (1836), a scholar from the Hanafi School, confirms that "to know the price is conditional in regard with validating any sale"¹²⁸. Al Rafiee, a Shafa'ee Scholar, further adds that "Ignorance of price or appraising, invalidates the contract"¹²⁹. Ibn Rushd Alhafeed (595H) of the Maliki School¹³⁰ as well as Ibn Kodama (620H)¹³¹, of the Hanbali School have made the same statement. Thus, the texts of scholars from the schools of *Fiqhi* are considered a clear indication that uncertainty in amount renders the contract null and void.

¹²⁷ Ibid.

¹²⁸ Ibn Abdideen(1836). *Hashiat Ibn Abidin*. Alhalabi for publishing. Cairo.v.2 p21

¹²⁹ Al Rafiee. Supura footnote 96.

¹³⁰ Ibn Rushd Alhafeed.(595H).*Bidait-ul-almujtahid*. Ibn hazim for publishing (1999). Cairo. v2 p172

¹³¹ Ibn Kodama Almaqdisy (620H). *Alkafy*. Dra Hajar for Publishing edition (2000). Cairo. V2.p71

This is exactly the situation with insurance contracts where different experts in civil law assert that insurance involves uncertainty in relation to the amount of compensation awarded, particularly with life insurance, as it is based upon compensation. When negotiating a contract, both parties are unaware regarding extent of damage or amount of compensation until such time as the insured risk occurs. What is more, the insurer himself does not know how much he will collect from premiums at the time of the incident.

On the other hand, from the perspective of someone who believes that insurance contracts are legitimate and that insurance companies with sophisticated means, employing the rules of statistics and actuarial science, can identify - with specific detail - the amount of indemnity to be paid to the insured party in return of an insured incident. In the same way, also determining the amount of compensation paid to the insured at the time of insured risk. So the answer to this, as El Qora Daghi (2006) concluded, is the fact that both parties should be aware of the contract details, even if we accept that the insurance company have the ability to assess risk and calculate the amount of compensation and that this knowledge is not be available to the second party, i.e. the insured. Furthermore, if the company is unable to ascertain the sum total owed by the insured person over a certain period, it cannot know how much will be paid, per person, in interest, so all this uncertainty remains and thereby rescinds the contract¹³².

d. Uncertainty regarding the Time of Payment of Insurance Amount (compensation):

The Islamic Sharia Scholars have formed a precondition for validating the reimbursement contracts. Here, time should be known, and contracts where time is unknown should be declared null and void. El Nawawi (631H) confirms that scholars agree upon this, thereby affirming that transactions omitting to specify time should be forbidden¹³³. Nevertheless, when applying this principle to the insurance contract, we find that the duration of the contract is often undetermined concerning a specific period (one year for example). Although,

¹³² El- Qora Daghi. A (2006), Islamic Insurance. Supra footnote 22.

¹³³ Imam El Nawawi(631H), *Almajmoo*. Dar Alfikrfor Publishing (1997).Beruit .V9.p339

exception is perhaps made for the payment of indemnification which cannot be determined in terms of involvement in the occurrence of risk.

- **The Second Element: Wagering and Gambling:**

The scholars support the prohibition of commercial insurance in Islamic Sharia law because it a type of wagering and gambling which is also considered as sin in certain European countries¹³⁴. For this reason, El Sanhoury (1964) has indicated that gambling is an agreement was each gambler undertakes to pay if he/she loses to another gambler. Payment can be in the form of money, or anything that has been mutually agreed upon. However, wagering is a pledge by which both gamblers undertake to pay if his/her chosen event is unrealised. The winner of this pledge will gain a sum of money¹³⁵.

Wagering and gambling is forbidden in Islamic law as God Says: *“O ye who believe! Intoxicant (all kinds of alcoholic drink) and gambling, and Al-ansab, and al-zlam (arrows to seek luck or decision) are an abomination of Shaitan’s (Satan’s) handiwork. So avoid (strictly all) that (abomination) in order that you may be successful.”*¹³⁶

Most Arab laws have prohibited gambling and wagering and have placed civil and criminal sanctions on those who practice such games (e.g. Article 739 of the Egyptian Civil Code, Article 705 of the Syrian Civil Code, and Article 739 in Libyan law amongst many others¹³⁷).

As far as the prohibitions of commercial insurance are concerned, El Qora Daghi (2006) has pointed out that the definition of betting and gambling, and the characteristics of contract formation, it does apply to the insurance contracts and such characteristics are covered in insurance contracts. In other words, a commercial insurance contract is undertaken by either party (i.e. the insurance company) to pay to the second party (i.e. the insured) a sum money, or any other agreed financial consideration. This is also the case where a certain incident (insured risk) is protected in exchange for a promise (from the insured), to pay a further amount

¹³⁴ Holdsworth, *A History of English Law*, (1925),supra footnote 10. Vol. 8, p.100

¹³⁵ Alsanhoury. *Alwaseet*.supra 26. V7.p 958- 986

¹³⁶ *The Holy Quran. King Fahad Complex for the printing of the Holy Quran. Chapter 5 (sorat al Maydah,)Verse90. P135. Available online*

http://www.islamway.com/SF/quran/data/The_Holy_Quran_English.pdf

¹³⁷ Alhamid.H.*The verdict of Shari’a on Insurance*. Supra footnote 88. P 105

namely, the annual premium of the said incident. Thus, the nature of the insurance contract is parallel to the nature of both gambling and betting contracts, but with different names, elements and parties: being one of the potential financial reimbursement contracts for both parties¹³⁸.

Insurance used to be disguised under the form of a legal contract. El Sanhoury (1964) stresses that the insurance contract consists of gambling and betting, and if viewed via the relationship between the insurance company and the insured, we find that insurance companies do not conclude contracts with a single insured party, or with a small number insured persons. However, if this was written into the insurance contract, then insurance would be considered as some sort of gambling or betting and would then represent an illegal contract. For example, where a company has contracted with an insured person who's house was burnt down, the house value, is paid; Alternatively, if the house was not burnt down, then the value of insurance, paid by the insured, represents pure profit for the company, which is arguably a real form of betting¹³⁹.

- **The Third Element: Usury (*Riba*) or Interest:**

Usury is a major sin as far as the Sharia scholars are concerned. To illustrate, in the Holy Quran Allah Says:

*"O ye who believe, be a afraid of Allah and give up what remains (due to you) from Riba (usury)(from now, onwards), if you are (really)a believer. And if you do not do this, then take a notice of war from Allah and his messenger. But if you repent, you shall have your capital sums. Deal not unjustly (asking for more capital sums), and you shall not be dealt with unjustly (by receiving less than your capital sums)."*¹⁴⁰

In Islamic Sharia *Fiqhi*, *Riba* is divided into two parts:

- The usury of credit (*Riba Alfazal*) which is intended to increase an indemnity in a unified manner for example where wheat is exchanged for wheat, with a certain increase. Prophet Mohammed (PBUH) stated that

¹³⁸ El Qora Daghi. A (2006), Islamic Insurance. Supra footnote 22.

¹³⁹ Alsanhoury. *Alwaseet*.supra 26. V7.p1086

¹⁴⁰ *The Holy Quran. King Fahad Complex for the printing of the Holy Quran. Chapter 2 (sorat al Bagarah) Verse278-279.p65. Available online http://www.islamway.com/SF/quran/data/The_Holy_Quran_English.pdf*

“exchange of gold with gold, silver with silver, wheat with wheat, barley with barley, dates with dates and salt with salt should be of equal quantities and spot. Anyone who varies the quantities or allows one side of the exchange to be deferred, indulges in riba for which both buyer and seller are equally responsible”¹⁴¹ (Sahih Imam Bukhari and Muslim)

Thus, based on this statement, a new kind of riba identified which is that in the case of the six commodities mentioned in it, if exchanged against themselves, the quantities should be equal and these should be exchanged simultaneously by both parties.¹⁴²

- Usury of long term credit (*Riba Alnaseiaa*) is a loan of Dirhams (money) taken for a known period of time, proportional to increases in the amount of the loan and accordingly, increases in debt, as well as duration¹⁴³.

Commercial insurance has two forms of usury as demonstrated via the following examples:

1. Amounts paid by the insured party in cash, may be refunded for more or less, when an insured risk (long term) occurs during the course of an existing contract based upon exchange, such as sales. Furthermore, the company in fact sells insurance policies which may then be refunded in cash, paying out either more, or less, after a certain period of time. So, if we consider the contract as a reimbursement contract, like a contract of sale, then this becomes the selling of cash in return for cash via long term credit (*Riba Alnaseiaa*), or usury of credit (*Riba Alfazal*).
2. The life insurance contract contains a clause undertaken by the company, where the lessee (the insured) is to be reimbursed if he/she is alive after a specified period, inclusive of premiums paid with interest. This can also be seen as usury.
3. When insurance companies deposit funds into banks using additional investment practices and financial tools, and then receive interests, this may be classed as usury.

¹⁴¹ Khan. Muhammed S. H.(1996). *Alrawdah Alnadiyah shareh Aldurrar Albaheyah*. Alkawther for publishing, Riyadh, Saudi Arabia, 4th Edition, 1996, volume 2, p229.

¹⁴² Shafi. M ,Usmani.M(1997). *The Issue of Interest*. Darulishat, Karach, Bakistan edition 1997. P16-17.

¹⁴³ Alsalih. M(2004)*Insurance between permission and prohibition*. Supra footnote 75. p.p 117-122

Investment through buying bonds or shares with gained interest, is forbidden as usury in Islamic law¹⁴⁴.

- **Fourth Element: Commercial Insurance - Taking Money Unjustly:**

The scholars of Islamic law hold that the insurance contract is essentially taking money from people unjustly. From this perspective, the contract is invalid, because of uncertainty levels namely, betting and gambling. At this point, Allah says:

*"O ye who believe, Eat not up your property among yourselves unjustly, except it to be a trade amongst you, by mutual consent"*¹⁴⁵.

El Qora Daghi (2006), reported that the Holy Quran provided permissibility to take people's money via two main prerequisites:

- Through a valid legitimate contract, or a contract not violating the law of God.
- Upon a mutual consent between two parties. Although the presence of mutual consent must be based upon a legitimate contract, which is not in contravention of the law of God.

¹⁴⁴ Alhamid.H.*The verdict of Shari'a on Insurance*. Supra footnote 88. P108. El Qora Daghi.A (2006), Islamic Insurance. Supra footnote 22.

¹⁴⁵ *The Holy Quran*. King Fahad Complex for the printing of the Holy Quran. Chapter 4 (sorat al Nisaa)Verse29. p112. Available online http://www.islamway.com/SF/quran/data/The_Holy_Quran_English.pdf

2.5.2.2.2 The view that commercial insurance is permissible:

This group of scholars asserts that commercial insurance is permissible in Islamic law and present certain evidences in this regard, as follows:

A- In Islamic jurisprudential study, the basis of contracts and related conditions are permissible, and in light of this, the insurance contract is a new contract and a new system within Islam. Thus, the commercial contract does not directly relate to any of the prevailing contracts and so, does not fall under any contract named in the Islamic Sharia. Therefore, on this basis, it should be allowed as a contract as long as it is not contravening Sharia law. As regards considering commercial contracts as gambling or betting, this point is not taken for granted however, the uncertainty in the contract is modest and a little uncertainty is allowed in the Islamic Sharia. Also, the usury issue it is not necessarily a fundamental/integral part of a commercial contract. Instead this can be considered as one of many routine practices carried out by insurance companies and therefore, can be set apart from usury.¹⁴⁶

B- Insurance can be analogised via legitimate contracts in Islamic law, inclusive of the following:

- The analogy of the insurance contract with the loyalty contract (*walaa almualah*):

A loyalty contract is a contract in Islamic Sharia *Fiqhi* where two parties pay each other the due ransom or blood money in the event of committing a crime or receiving an inheritance. This contract prevailed before the rise of Islam and has since been confirmed by Islam.

The logic behind this reasoning is that a loyalty contract is not a matter of consensus among the Sharia scholars. Thus, this analogy is inaccurate since one of the conditions of Islamic jurisprudence is that the foundations must be agreed upon.

- The Analogy of Insurance as a Road of Risk:

According to al Zarqa, the matter of ensuring the road of risk at Hanafi School is a jurisprudential idea which fits with the mainstay of permissible insurance risk. An example of

¹⁴⁶ El Qora Daghi.A (2006), Islamic Insurance. Supra footnote 22. Albarry.Z.(1977).*Alwaseet fe Ahkaam altarirkat*.Dar alnahdah Publishing edition (1973). Cairo. Alsalih. M(2004)*Insurance between permission and prohibition*. Supra footnote 75. Alzarqa.M(1964)*The verdict of the insurance contract in Islamic sharia*. Supra footnote 88 23-24

this would be, "...if one person said to another "take the following path, it is secure, I will guarantee your safety if anything befalls." So in this example, the Insurer ensures the safety of goods sent as via an approved "line of road".

Some scholars have answered this, arguing that the basis of bail and guarantee are contributions or donation contracts whereas, insurance is a type of exchange or reimbursement contract. In this scenario the collected money from bail would be nullified as it is not valid for one person to tell another, "I will guarantee you etc..." This is not permissible in Islamic law, thus highlighting the difference. ¹⁴⁷

2.5.3 THE RULE OF COMMERCIAL INSURANCE IN ISLAMIC SHARIA

A set of legal, and Sharia, provisions have been issued on the topic of commercial insurance both in the past, and at the present time. First and foremost is the statement by "Ashhab", one of the Maliki scholars who lived two hundred years after Hijra, the "Messenger's Migration", stated: "The guarantee should not be for a certain price, but never believe when one man says to another that he will guarantee a commodity over a certain time, because, when money has been exchanged for a matter that cannot be sold or purchased, this constitutes uncertainty and gambling"¹⁴⁸.

Ahmad Ibn Yahya (1436) asserts that a "...guarantee for stolen or sunken objects is null and void ", and that this is applicable to marine insurance and insurance against fire¹⁴⁹.

El Qora Daghi (2006) has indicated that such fatwa's are not equivalent to conclusive evidence that the issue of insurance was known at that time among the scholars of Islamic Sharia. El Qora Daghi (2006) also added that it is possible that marine insurance was in place and widespread in the West before Ahmad bin Yahya¹⁵⁰.

¹⁴⁷ Ibid.

¹⁴⁸ Alswailam.S (2009). *Stoppages in Insurance Issue*. International Islamic Bureau for Economic and Finance. Available online http://www.sfhatk.com/vb/uploaded/471_21252008374.rar

¹⁴⁹ Ibn Yahya. A(1436). *Albahar Alzaikher*. Alrisalah Establishment for Publishing. Beirut. Edition2 (1984).

¹⁵⁰ El qora Daghi. A (2006), supra 22.

However, the first scholar to speak about insurance provisions in its traditional form was Ibn Abideen (1836) he said, “It is a tradition that if traders rent a boat from a non-Muslim, they paid to him his wage and paid also extra known money for another person living in his country. This extra money was called (*SOKRAH*) provided that if some of the money in the boat is fired, sunk or stolen, this man who lives in the country guarantees this money against what he takes from them...); then he said (I think that traders have no right to take a compensation for the damages”.¹⁵¹

In December 1906, the Grand Legitimate Court of Egypt deemed that a lawsuit claiming for an amount of life insurance is legally invalid in view of Sharia due to the containment of non-permissible facts. This opinion has been supported by the Egyptian Higher Council of Endowments, with successive views from its members based on the prohibition of insurance and debated over several conferences featuring insurance. The first conference was in 1961, “The Second *Fiqhi* Week Conference” which took place in Damascus. Here, scientists were divided between those who see insurance as totally prohibited and those who believe that it is permissible if free of usury¹⁵².

At the Second Conference of Islamic Research, under the World Islamic Association, held in 1965, the conference examined the issue of insurance, in which Ali El Khafeef, a member of the Islamic Research Academy, presented research on insurance. At this point, the conference formed a special committee, the Committee for Jurisprudential Researches¹⁵³.

On 24.4.1968, the Fatwa Committee at Al-Azhar issued a ruling prohibiting all kinds of commercial insurance. Then, in 1972, the Secretariat of the Islamic Research Academy demanded that the opinion of Muslim scholars must be respected in the world. Thus, more than 85 countries, including Egypt, Indonesia, Jordan, Syria, Iraq, Lebanon, Libya and Morocco, agreed to prohibit insurance¹⁵⁴.

¹⁵¹ Ibn Abdideen(1836). *Hashiat Ibn Abidin*. Alhalabi publisher. Cairo. Supra footnote 99.V2, p21. Altwajery. A (2009). *Altaameen almua'asir fi muzan alsharia* .Supra 28. P22

¹⁵²El qora Daghi. A (2006), supra 22.

¹⁵³ Ibid

¹⁵⁴ Ibid.

During the 6th-11th of May 1972, at the University of Libya Symposium, a selected host of Sharia and economics scholars discussed the issues surrounding insurance contracts and reached a decision, including the prohibition of life insurance and also the permissibility of insurance contracts; to be temporarily replaced by cooperative insurance¹⁵⁵.

On 4/4/1397H 24/04/1977, the Council of Senior Scholars in Saudi Arabia issued a rule that confirms the permission of cooperative insurance and forbids commercial insurance¹⁵⁶.

Throughout this historical jurisprudential review it has been the main intention to shed light on the efforts exerted by scientists and scientific academics, noting how they reached a decision - which has not been made in haste -, but based upon study and consultation over the last 25 years.

On 10/08/1389H 22/10/1969, the Islamic *Fiqhi* Academy of the Muslim World League issued a decree for the prohibition of all forms of commercial insurance, whether for self, for merchandise or otherwise, and the permissibility of cooperative insurance was confirmed. The International Islamic *Fiqhi* Academy then provided Resolution 9 (9/2) stating that "a commercial insurance policy with fixed-premium companies that deal in commercial insurance with an element of uncertainty, invalidates any contract which is therefore forbidden in Islamic Sharia."¹⁵⁷

Through this presentation, it is clear that Sharia scholars have concluded that commercial insurance is forbidden as it does not correspond with the instructions of Islam.

¹⁵⁵ Ibid.

¹⁵⁶ The General Presidency of Scholarly and Ifta in Saudi Arabia. *Decision no (5/10)Insurance subject*. Edition (2001). V4. P 307. Available online at:

<http://www.alifta.net/Fatawa/fatawaDetails.aspx?BookID=1&View=Page&PageNo=1&PageID=410>

¹⁵⁷ The International Islamic *Fiqhi* Academy. Conference 1 (1969). Available online at:

<http://www.fiqhacademy.org.sa/qararat/2-9.htm>

2.6 Takaful Commercial Insurance

Takaful is a system of Islamic insurance based on the accepted principle of Ta'awun (mutual assistance) and Tabarru (voluntary contribution), where risk is shared collectively by the group. This system is operated on the basis of shared responsibility, brotherhood, solidarity and mutual cooperation or assistance, providing mutual financial security and assistance to safeguard participants against a defined risk. Various types of *Takaful*, incorporating these principles, are detailed below:

2.6.1 THE BASIC PRINCIPLE OF TAKAFUL COMMERCIAL INSURANCE

The basic principles of *Takaful*, according to Islamic values are:

- Policyholders co-operate amongst themselves for the common good.
- Every policyholder pays his/her subscription to help those that need assistance.
- Losses are divided and liabilities spread according to the community pooling system.
- Uncertainty is eliminated in respect of subscription and compensation.
- No one member of the scheme derives advantage to the cost of others.¹⁵⁸

2.6.2 TAKAFUL TYPES

2.6.2.1 Family Takaful

According to Ali (1989), with this type of *Takaful* insurance the policy has a defined period of maturity, and the insured commonly make periodic premium contributions which are primarily used to meeting individual savings targets and in part, to financially assist bereaved families of the deceased insured. Premium amounts vary depending on the sum (face amount) that each insured party aims to accumulate at the end of the coverage period as well as on details such as age, gender and health condition of the insured party. The insurer may set a minimum face

¹⁵⁸ These principles are derived from the general concept of Islamic scholars in respect of insurance, and from the in-depth reading of books such as: El Qora Daghi.A (2006), *Islamic Insurance*. Supra footnote 22. Albarry.Z.(1977). Alsalih. M(2004)*Insurance between permission and prohibition*. Supra footnote 75. Alzarqa.M(1964)*The verdict of insurance contract in Islamic sharia*. Supra footnote 88.

amount for this purpose and may also set a minimum/maximum age limit for participating in this type of policy. By the same token, the insurer may decide to accept standard risks only and may maintain separate classes of policy holder, perhaps organised by age, but with different years of entry to the plan¹⁵⁹.

Takaful life insurance is also used for other purposes, including generating a fund for children's education, securing a fund in case of a mortgagor's premature death and protecting business interest against key employee's deaths. Several *Takaful* policies now come with hospitalisation and disability benefits. In fact, there is virtually a counterpart *Takaful* life insurance policy for each major type of conventional life insurance policy, while difference lie in how premiums are allocated¹⁶⁰.

However, by using investment as a methodology, a *Takaful* operator (insurer) credits instalment premiums over two separate accounts - the individual account and the special account pertaining to each insured party. *Takaful* insurers then invest those funds in individual and special accounts in the form of mutual funds, primarily consisting of stocks in financial institutions and manufacturers, so long as their goods and services are permitted by Islamic Sharia. See figure below¹⁶¹.

¹⁵⁹ Ali, Kasi Mohammed. Mortuza, 1989. "Principles and Practices of Insurance under Islamic Framework," Insurance Journal, (December): 29-38.

¹⁶⁰ See Malaysia Takaful available online <http://www.takaful-malaysia.com.my/family/products/Pages/default.aspx>

¹⁶¹ Ali, Kasi Mohammed. Mortuza, 1989. Supra footnote 150.

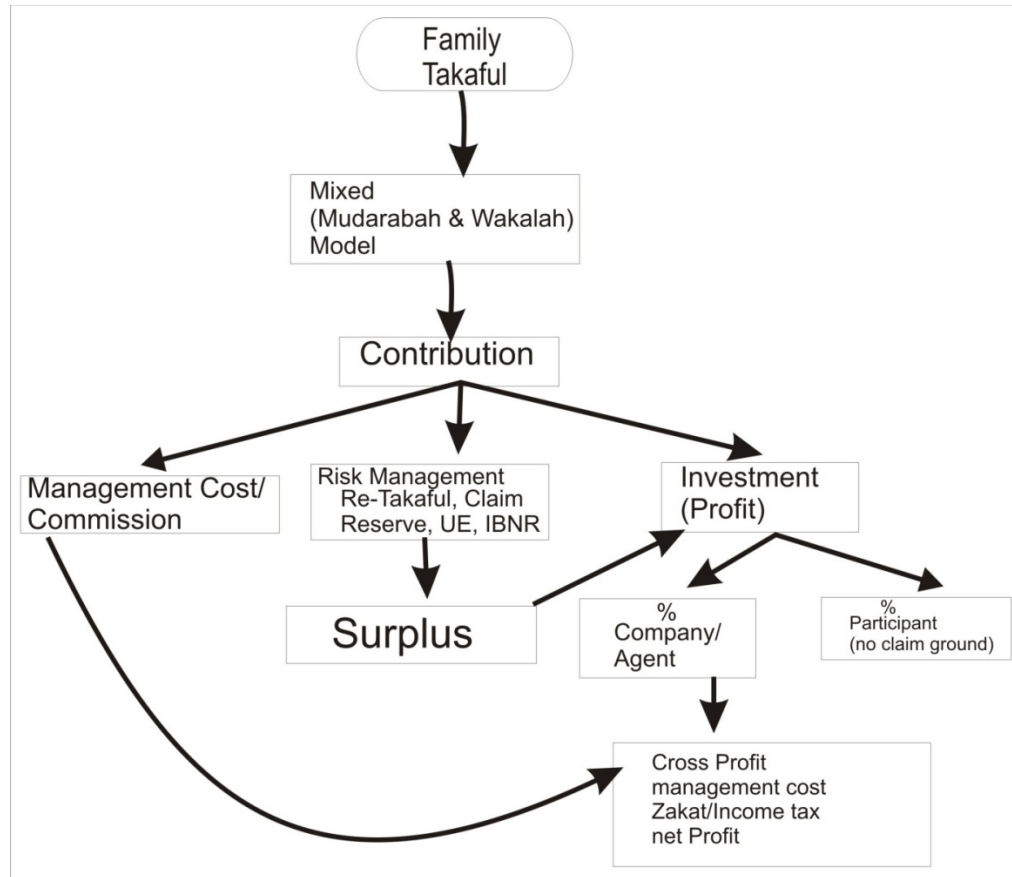


Figure 2.1: The Process of Family *Takaful*

However, if an insured party goes on to meet their target savings, determined at policy inception, the insured receives a refund on all premiums that he/she has paid in addition to his/her share of investment income from that account. In addition, his/her share of surplus will be assessed from the special account¹⁶².

Takaful insurers also permit their insured population to surrender policies prematurely. When an insured party exercises this option, he/she will receive a refund of all premiums plus his/her share of surplus from the individual account (minus administrative expenses) until the date of surrender. However, no refund is awarded from the special account in cases where a policy is surrendered. Typically, with a *Takaful* insurance plan, it matters little whether or not an

¹⁶² Ibid.

insured party surrenders in the manner prescribed via his/her policy, since all insured's are, in principle, partners of the insurance plan¹⁶³.

2.6.2.2 General Takaful (Non-Life Insurance)

In non-life insurance, *Takaful* insurers commonly offer coverage on an annual renewal basis, for everything from fire insurance and allied lines, automobile insurance, liability insurance, marine insurance, workers' compensation, fidelity insurance and even crop insurance. In *Takaful* life insurance, the *Mudarabah* mode of financing is employed in General *Takaful*. Premiums are pooled into a *Takaful* fund managed by each insurer.

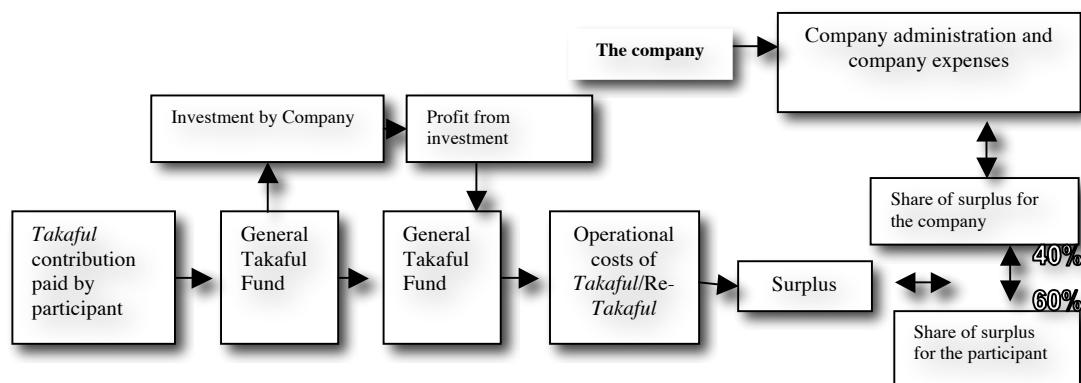


Figure 2.2: The process of General *Takaful* contract

In this system, the insurer acts as trustee, invests funds in Islamic ways and channels the investment income, less investment expenses, back into the fund. The insurer then settles all outstanding claims, deducts its operating expenses and transfers part of the fund to relevant reserves.

If there a balance is leftover after all necessary adjustments, the balance will be shared by the insurer and its insured in accordance with an agreed ratio e.g., 50 percent each. This surplus is normally distributed on expiry of each insured parties insurance policy. If, however, the sum of the premium and investment income is insufficient to meet these adjustments, those affected may be assessed for additional contributions. Accordingly, *Takaful* non-life insurance

¹⁶³ Ibid. More information on family *Takaful* is provided in chapter 3.

works similarly, albeit not exactly, agreeing assessable, mutual insurance arrangements in a conventional insurance context¹⁶⁴.

2.6.2.3 Re-Takaful (Re-Insurance)

In terms of risk-sharing and pricing, Maysami, Ramin (n.d.) has stated that reinsurance transfers are commonly classified into proportional and non-proportional arrangements. In *Takaful* reinsurance (also known as *retakaful*), non-proportional arrangements such as excess of loss, or stop-loss arrangements, may not be suitable because uncertainty exists with respect to the assessment of losses in those arrangements, where Islamic principles demand clearly defined joint responsibility throughout the coverage period. Hence, *Takaful* reinsurance is likely to be arranged on a pro-rata basis, e.g., quota share or surplus reinsurance, where the re-insurer technically becomes a co-insurer of the original risks¹⁶⁵.

Maysami, Ramin (n.d.) added that if, however, a non-proportional reinsurance arrangement is selected, it could be based on a strict profit commission plan or on a reciprocal basis. In this case, it matters little whether the reinsurance transfer is on a facultative or treaty basis. Due to the fact that only a few *Takaful* reinsurers are currently operating, the capacity of the *Takaful* reinsurance market would not be large enough to accommodate the demands from *Takaful* insurers. As such, *Takaful* insurers often create and operate a pool, pursuant to Islamic principles in order to minimize their exposure to certain, catastrophic risks. They can also be allowed to enter into contractual agreements with conventional re-insurers. In fact, a number of conventional re-insurers have provided reinsurance protection to insurers, *Takaful* or not, throughout several Islamic countries.

¹⁶⁴ Manjoo. F. (2007) Risk Management; A *Takaful* perspective, Published by Alnoor 2007 Kensington, South Africa. P16

¹⁶⁵ Maysami, Ramin (no date). *An Analysis of Islamic Takaful Insurance*. Available online at: <http://www.isu.ac.ir/farsi/academics/economics/edu/dlc/2rd/09/other/analysis%20of%20Islamic%20Takaful%20Insurance.pdf> . Retrieved on 09-08-2012.

However, although this may not be strictly followed by insured parties, Muslim jurists advise that *Takaful* insurers cease purchasing coverage from conventional re-insurers when a *Takaful* re-insurer becomes available¹⁶⁶.

2.6.3 THE MODEL OF TAKAFUL

The terms “Family Takaful” or just “*Takaful*” are generally used for family solidarity in place of conventional life insurances. Other products, available in various countries, are General *Takaful*, Education/Medical *Takaful*, etc. Based on the nature of the relationship, Ali Khan stated that there are various models including *Wakalah* (agency) Model, *Mudarabah* (share in profit) Model and the combination of agency and *Mudarabah* models or agency and *waqaf*.

2.6.3.1 The Mudarabah model (share in profit)

In the *Mudarabah* model the policyholders receive profit on their part of the funds only if/when a *Takaful* Company earns a profit. The sharing arrangement is determined in advance and is a function of the developmental stage and earnings of the Company. The Sharia committee approves the sharing ratio for each year in advance. Most of the expenses are charged to the shareholders¹⁶⁷.

2.6.3.2 The Wakalah Model

In the *Wakalah* Model, the surplus of policyholders’ funds and investments – net the management fee or expenses – goes to the policyholders. The shareholders charge a *Wakalah* fee from contributions and this fee covers most of the expenses of business. The fee rate is fixed annually, in advance, and in consultation with the company’s Sharia committee. In order to give incentive for good governance, management fees are related to level of performance¹⁶⁸.

¹⁶⁶ Ibid.

¹⁶⁷ Manjoo. F. (2007) Risk Management; A *Takaful* perspective. Supra footnote 155.

¹⁶⁸ Ibid.

2.6.3.3 Wakalah with waqaf

In *Wakalah* with waqaf, this *Takaful* model employs the following contracts to govern their business:

- A pure donation contract (for *Waqf* motives alone), where the participant agrees to donate a pre-determined percentage of their contribution to the *Waqf* fund to provide assistance to fellow participants.
- The agency (*Al-Wakalah*) contract where the participant (waqif) authorises a *Takaful* Company (agent) to conduct affairs relating to the Risk and Special Fund on his /her behalf, hence all Islamic verdicts regarding this contract are referred specifically to the agent (*Nazer- u- alWaqf*) including applications and *Fiqhi* books.¹⁶⁹

2.6.4 TAKAFUL INSURANCE SIMILARITIES & DIFFERENCES¹⁷⁰

Ali Kasi, (1989) identified some considerable similarities and differences between *Takaful* and conventional insurance.

2.6.4.1 Similarities

Takaful and conventional non-life insurance is similar in that they both adopt several key legal principles in terms of insurance. Most notably, both types of insurance employ the principle of insurable interest to minimise the problems of moral hazard, i.e., to separate insurance from gambling.

Using the principle of *uberrima fides*¹⁷¹, both *Takaful* and conventional insurers can render contract void if there is material misrepresentation, concealment or breach of warranty made

¹⁶⁹ Liaquat, Ali Khan..*HOW DOES TAKAFUL DIFFER FROM INSURANCE?* . From assaif.Org. Available online:

http://scholar.google.co.uk/scholar?q=HOW+DOES+TAKAFUL+DIFFER+FROM+INSURANCE%3F+&btnG=&hl=en&as_sdt=0%2C5&as_vis=1 . Retrieved on 09-08-2012.

¹⁷⁰ Basically, there are a considerable number of differences between both of them, referred to in the next chapter, where I am going to talk about the *Takaful* models in depth.

¹⁷¹ *Uberrima fides* a *Latin* phrase meaning "utmost good faith" (or translated literally, "most abundant faith"). It is the name of a legal doctrine which governs insurance contracts. available online on ; http://en.wikipedia.org/wiki/Uberrima_fides

by the insured. Regarding innocent misrepresentation or breaches of warranty, conventional insurers are either unlikely to void or are forbidden to do so by statute or code of law. Similarly, *Takaful* insurers may not void such a contract. Further, those insured's that serve the Sharia supervisory board may object to their insurer exercising this option, as they represent other insured's contributing to the company¹⁷².

2.6.4.2 Differences

Differences, however, exist. In conventional insurance, insurers use a "valued policy" for certain types of properties where the insurer agrees, total loss, to indemnify the value agreed upon at policy inception. For partial loss, the insurer may pay more (or less) than the indemnity if the actual value of the property, at the time of loss, falls below (or increases above) the coverage limit.

Cash value arrangements are not permitted in *Takaful* (Ali, 1989). Neither is this accepted in Islam i.e., depreciation of property value is not permitted. *Takaful* insurers are thus willing to extend coverage only after conducting a proper valuation of the property to be insured.

Further, *Takaful* insurers conduct a periodic valuation of the insured property to eliminate any discrepancy between the existing insurance coverage and the current market value of the property insured, and adjust premiums accordingly. These valuation restrictions compel that property insurance be placed on a replacement cost basis in order to suit Islamic principles¹⁷³.

2.7 survey of Takaful operations

During the past three decades we have seen *Takaful* operations opening up in many countries throughout the world, primarily in Islamic countries and countries with a large Muslim community. The world's pioneer *Takaful* insurer was established in 1979 – the Islamic Insurance Company of Sudan, followed by the Islamic Insurance Company of Saudi Arabia, in the same year.

¹⁷²Ali, Kasi Mohammed. Mortuza, 1989. Supra footnote 150.

¹⁷³Ibid.

In the Far East, Malaysia has been at the forefront of *Takaful* development with Bank Negara taking the lead introducing separate *Takaful* regulations thereby allowing the *Takaful* business to flourish in that country. Singapore, Indonesia and Brunei have all followed with the development of *Takaful* operations. In the Middle East, *Takaful* operations have developed in Saudi Arabia, Bahrain, Iran, Qatar and Iran with more new operations to be opened up in Egypt, UAE and Kuwait in recent years. It is fair to say that the Far East and Middle East regions lead the way in *Takaful* development but other countries are also moving in this direction i.e. Bangladesh and Sri Lanka¹⁷⁴.

Outside these two primary regions, *Takaful* has also been introduced into Europe and the USA but, as yet, development of *Takaful* in the western world has not met with any major degree of success. There is no doubt that there is a tremendous opportunity for *Takaful* to develop in these regions, with large Muslim communities being able to avail themselves of *Takaful* products and services.

Nevertheless, significant investment is required to compete with the conventional insurance industry and regulatory changes would also be necessary, as seen in the Malaysian market, to allow *Takaful* to compete on equal terms with conventional insurance operators.

However, *Takaful* industry in the Middle East is under-developed compared to other markets such as those in Malaysia. The more successful companies in the Middle East have grown at 10% p.a. whereas in Malaysia the rate of growth has been 60% p.a. The total insurance premium income of the world is \$2.4 trillion whereas in *Takaful* the total premium income is \$2.1 billion¹⁷⁵.

Against conventional insurance, only five percent of the population in Muslim countries are taking advantage of these insurance facilities, and only where it is a legal obligation to obtain insurance. Therefore, 95% of the population are not buying insurance due to the concept that insurance is un-Islamic. By using *Takaful* as Islamic insurance a large population out of the remaining 95% could be encouraged to take out insurance in the form of *Takaful*. *Re-Takaful*

¹⁷⁴ Liaquat, Ali Khan. Supra footnote 158.

¹⁷⁵ Ibid.

(Reinsurance) companies are few and far between and generally, the *Takaful* operators are using the services of normal re-insurers¹⁷⁶.

Mutual based insurance companies have been providing insurance products relating to personal lines in limited amounts. Thus, on the basis of mutuality, *Takaful* operators cannot insure large commercial risks involving huge amounts of capital because these risks will require insurance companies with large amounts of capital.

Therefore, the Saudi Government has increased the limit of capital for an insurance company to 100 million Riyals, and 200 million for reinsurance companies¹⁷⁷.

2.7.1 TAKAFUL IN ARABIAN COUNTRIES

The development of a cooperative form of insurance in this region probably dates back to the pre-Islamic period when each tribe tried to protect the life and property of its members. For example, if one member killed another, then the family of the perpetrator was expected to pay "blood money" to the surviving family of the deceased. It is also well known that, around 1500 BC, Syrian rulers accumulated funds from public taxation to pay for fire, flood or draught losses suffered by community members. At present, there are several Islamic insurers and three re-insurers domiciling in the Middle East and the North Africa region¹⁷⁸.

The biggest of these re-insurers is the Jeddah-based Islamic Insurance and Reinsurance Company. The other two re-insurers are the Islamic *Takaful & ReTakaful* Company in Jeddah and the BEST Re in Tunisia founded in 1985. The latter company is fully owned by SALAMA Group (Dubai – UAE), which also comprises 7 other direct *Takaful* companies.¹⁷⁹ However, Alpen Capital expects the Gulf Cooperating Council's (GCC) *Takaful* market to continue to grow faster than the Gross Domestic Product (GDP) (non-oil). Based on both the

¹⁷⁶ Ibid.

¹⁷⁷ Saudi Arabian Monetary Agency. SAMA

<http://www.sama.gov.sa/sites/samaen/Insurance/Pages/LawsandRegulations.aspx> , Retrieved on 15-08-2012.

¹⁷⁸ Maysami, Ramin. *An Analysis of Islamic Takaful Insurance*. Supra footnote 156

¹⁷⁹ Ibid.

current macroeconomic outlook, and a set of assumption detailed below, Alpen Capital expects the market to grow at an approximately nominal and real Compound Annual Growth Rate (CAGR) of 20.7% and 16.1% respectively (from 2009 to 2012). The performance of the industry in the first nine months of 2009, with double digit top-line growth in each quarter on an aggregate basis, supports these growth estimates¹⁸⁰.

- **Saudi Arabia**

In Saudi Arabia, according to Saudi Arabia Monetary Agency (SAMA) there are 43 companies applying *Takaful* with US \$1.39 b indemnities in 2008 compared with US \$680.52 million in 2005¹⁸¹. Here, the National Company for Co-operative Insurance (NCCI) was the first company to apply Islamic cooperative insurance.

As a joint venture, established in 1986 by three government agencies, this type of insurance underwrites risks in the oil industry worldwide, as well as the aviation fleet risks of Arab nations. In fact, the NCCI recently achieved 1st position with stock market shares valued at US\$ 200 million¹⁸². However, in order to enhance the insurance market, SAMA stipulates SAR 100 million for insurance companies and SAR 200 million for reinsurance.

- **Kuwait**

In Kuwait, the Ministry of Commerce and Industry granted a license for the first *Takaful* insurance company as recently as February 1998. This new company, capitalised at US\$98 million, has eight major shareholders including Kuwait Finance House, the International Investor and International Murabaha (the main Islamic financial institution in the country). This company is expected to offer a full range of *Takaful* products in the near future. There are now more than 9 *Takaful* and Re-*Takaful* companies in Kuwait¹⁸³.

¹⁸⁰ Alpen Capital. (2010). *GCC Takaful Industry*.P6

¹⁸¹ Saudi Arabia Monetary Agency (SAMA) report 2008 available online; http://www.sama.gov.sa/Insurance/InsuranceLib/4600_R_InsuaMarketSurvey2008_Ar_1430_05_21_V1.pdf . Retrieved on 09-08-2012.

¹⁸² Tawuniy. Performance available online at; <http://www.tawuniya.com.sa/Home/AboutUs/AboutTawuniya/Performance/tabid/379/Default.aspx> . Retrieved on 13-08-2012

¹⁸³ Alpen Capital. (2010).supra footnote 131.

- **The UAE**

In the UAE, Insurance regulation is presently minimal and undergoing revision. Indeed, a new insurance law came into force in August 2007 thereby establishing the Insurance commission, a new regulatory body for locally incorporated companies. However, requirements for *Takaful* companies have not yet been decided. On the contrary, the Dubai International Financial Services Centre (DIFC), an offshore financial centre, requires *Takaful* firms operating within the DIFC to operate outside the Prudential Insurance Rule book (followed by conventional insurers) and to fulfil the requirements of the Islamic Financial Services Rulebook (IFS). There are now more than 16 *Takaful* and Re-*Takaful* companies in the UAE¹⁸⁴.

However, the insurance market in many other countries in the region has recently shown a considerable growth rate, although the insurance penetration ratio and the insurance density in those countries are relatively lower than those in more economically mature countries.

For example, the Lebanese insurance market enjoys a high level of awareness among the general public, who tend to be well educated. Its non-life insurance accounts for nearly 80 percent of total premiums but, unfortunately, there is no *Takaful* operation in existence here. Alternatively, in Egypt, legislation was passed in the early 1990s to allow the eventual establishment of a free market system, but the first *Takaful* operation came latterly in form of the National *Takaful* Insurance Co (2008)¹⁸⁵.

2.7.2 TAKAFUL IN EAST ASIA

- **Malaysia**

As stated by Maysami Ramin, Malaysia, introduced the *Takaful* Act in the early 1980s in order to legitimise *Takaful* operations and is probably the only country in the world with such a law. After passing the act, Bank Negara (the central bank of Malaysia) was appointed to

¹⁸⁴ Ibid. P28

¹⁸⁵ Ibid.P30

regulate *Takaful* operations and to monitor the compliance of *Takaful* insurers within the Sharia. Syarikat *Takaful* Malaysia, a subsidiary of Bank Islam Malaysia, was the first to obtain a *Takaful* operation license under the act. This was incorporated in 1984 and commenced operations in 1985 both in life, and non-life lines. In 1993, Malaysia's National Insurance MNI *Takaful* was licensed and has since been operating in Malaysia. This latter insurer currently focuses on enhancing customer services technology and on developing new marketing channels, e.g., policyholders' services through post offices. Malaysia's National Insurance Company, the largest local insurance company, currently owns about 80 percent of the shares in MNI *Takaful*¹⁸⁶.

- **Singapore**

In Singapore, *Takaful*, together with Islamic banking, has been viewed as a tool to promote the economic development of the Islamic community and comprises approx. 15 percent of the population. Currently, two *Takaful* insurers are in operation, both created in 1995. The Ampro-Income *Takaful* Company is a joint venture between Ampro Holdings of Singapore (mainly in manufacturing business) and NTUC-Income Insurance Co-operative (a local mutual insurance company dominating personal lines of insurance and with a relatively large number of Muslim insurance agents). The other *Takaful* insurer is Syarikat *Takaful* Singapura (STS), a joint venture business between Keppel Insurance Company and Singapore Malay Teachers' Multi-purpose Co-operative Society¹⁸⁷.

- **Pakistan**

In Pakistan, the Securities and Exchange Commission of Pakistan (SECP) is the regulatory authority of the insurance industry operating in accordance with the Insurance Ordinance 2000. Here, thus far, the *Takaful* business has not been introduced. However, the Insurance Ordinance, 2000 has made provisions for *Takaful* business. Islamic banking institutions require the support of *Takaful* businesses. As such, the SECP has constituted a four-member task force, which will frame rules and regulations for *Takaful* businesses in Pakistan. Furthermore, Pak Kuwait Investment Corporation has been allowed to establish a *Takaful*

¹⁸⁶ Maysami, Ramin. *An Analysis of Islamic Takaful Insurance*. Supra footnote 124.

¹⁸⁷ Ibid.

company in Pakistan under the name of “First *Takaful* Insurance Company Ltd.” with an authorised capital of Rs.100 million¹⁸⁸.

2.7.3 THE WEST

- **The USA**

Interestingly, *Takaful* is observed in the non-Islamic world too. The USA hosts the largest insurance industry in the world, accounting for 30% of total worldwide premium income, compared with 11% in Japan¹⁸⁹. The US has many *Takaful* operators, for example, USA *Takaful* Management Services; LLC (Wayne, NJ) is just one of several *Takaful* insurers in operation. Established in 1996, this company provides *Takaful* life and non-life insurance coverage’s in both personal and commercial lines. Other US *Takaful* insurers, or financial institutions operating under Sharia principles, include: Failaka Investments (Chicago, IL), Samad Group (Dayton, OH), North American Islamic Trust (Indianapolis, IN), Baitul Mai., Inc. (Secaucus, NJ), Abar Investments, Inc. (Stamford, CT) and MSI Finance Corporation (Houston, TX)¹⁹⁰.

- **The UK.**

The UK insurance industry is the largest in Europe and the third largest in the world after the USA and Japan, accounting for 11% of total worldwide premium income. The UK's annual per capita insurance spend is approximately £2,500 (US\$4,600), which is the second highest in the world after Switzerland (as of 2005). Most people in the UK purchase some form of insurance and over 60% of households in the UK subscribe to home-related insurance, while more than 70% are covered for motor insurance¹⁹¹.

¹⁸⁸ Liaquat, Ali Khan. Supra footnote 125.

¹⁸⁹ The UK insurance – key facts (2009). *Associations of British insurers*. Available online; http://www.abi.org.uk/Facts_and_Figures/46809.pdf. Retrieved on 09-08-2012.

¹⁹⁰ Maysami, Ramin. *An Analysis of Islamic Takaful Insurance*. Supra footnote 124.

¹⁹¹ The UK insurance – key facts (2009). *Associations of British insurers*. Supra footnote 137.

A UK survey conducted by British Islamic Insurance Holdings (BIIH), revealed that the first *Takaful* Company in the UK (founded in May 2008), decided to launch with capital of £80 million. The survey actually indicated a strong preference for Sharia compliant insurance solutions amongst UK Muslims with 50% responding that they were “extremely likely” or “very likely” to buy Motor *Takaful*, as long as all aspects of the policy, including cost and level of cover, are comparable with their existing conventional insurance policy. A further 26% said that they would be “fairly likely” to buy Motor *Takaful*. The corresponding figures for Household *Takaful* were 46% and 28% respectively¹⁹².

However, *Takaful* insurance is also found in Switzerland, Belgium and Australia.

2.8 The Regulation of Takaful

Regulation is still in its infancy with many jurisdictions, there are different models of *Takaful* in use and different regulatory approaches. In regulating *Takaful* companies, the regulators may, in general, seek assistance from the administrative principles of conventional insurance companies. The regulators may use the conventional principles and actuarial rules for *Takaful* companies. This is an administrative procedure that would not be objected to by Sharia.

In the UK or Dubai, for example, in authorising a *Takaful* operator, the Financial Services Authority FSA or Dubai Financial Services Authority DFSA will in general consider:

- Risk assessment
- Conduct of business

Takaful operators must comply with the Insurance Conduct of Business (ICOB) rules which seek to carry out the obligations set out in the (FSA)’s Principles for Businesses, for example: Observe proper standards of market conduct, Observe high standards of integrity and treat customers fairly.

¹⁹² AME info website. (2007). *British Islamic Insurance Holdings (BIIH) reaches important milestone*. Available online: <http://www.ameinfo.com/122505.html> Retrieved on 09-08-2012.

- Capital adequacy

Takaful operators must have sufficient financial resources to meet claims as they fall due, also the capacity of Solvency and margins Admissibility of assets, finally address capital adequacy under the *Wakalah / Mudarabah* models.

- Management, Systems and Controls

Takaful operators must employ adequate human resources, competent and prudent management, persons occupying “controlled functions”, IT systems and Sharia compliance.

- Disclosure

This involves the submission of a business plan, regular reports and co-operative and open dealings with the FSA or DFSA¹⁹³.

Furthermore, the Saudi Arabian Monetary Agency (SAMA), regulator of the Saudi Arabian insurance market, mandates all insurance companies to be established in a cooperative manner. SAMA also directs the cooperative insurance companies to distribute 10% of the net surplus of insurance surplus to policyholders directly or in the form of a reduction in premiums for the following year. The remaining 90% of the net surplus is transferred to the shareholders. SAMA also mandated all insurance companies (existing and new) to obtain a license by March 2008 to underwrite business or exit the market. Notably, to obtain a license, a company must be established as a joint stock company, invest at least 20% of policyholder funds in government bonds and 20% in bonds issued by Saudi-authorized banks¹⁹⁴.

As a result, as of August 2009, out of the 43 companies operating in Saudi Arabia in 2008, 25 insurance and reinsurance companies were fully licensed to operate in the Kingdom and 6

¹⁹³ FSA, The Full Handbook available online <http://fsahandbook.info/FSA/html/handbook/>. The DFSA Rulebook. The Actuarial Profession presentation available online <http://www.actuaries.org.uk/?a=127387>. Retrieved on 10-08-2012.

Prudential – Insurance Business Module (PIN). See also Michael Ainley and group (2007) Islamic Finance in the UK: Regulation and Challenges. Available online; http://www.fsa.gov.uk/pubs/other/islamic_finance.pdf . Retrieved on 10-08-2012.

¹⁹⁴ SAMA. Supar footnote 171.

companies have been approved to be established by the Council of Ministers¹⁹⁵. Nowadays, there are 33 insurance companies listed in Saudi market¹⁹⁶.

Accordingly, administrative procedures would not be objected to by Sharia, as administrative procedures are actions that do not involve any contractual undertakings which may go against the principles of *Takaful* operations.

The Sharia allows participants to benefit from the positive features of conventional insurance management and regulation methodology on the basis of the principle of valid public interest (*masalaha mu'tabara*) or principle of Legitimacy Policy (*alsiyasah al-shari'yyah*). These principals are employed to allow the formation of rules and regulations - since no explicit rules of insurance are featured in the Qur'an and *Sunnah* - provided their use will not violate the basic principles of Islamic law.

However, the foundation of the mechanism for monitoring segregated funds regulations is different. So, it is suggested that the relationship between *Takaful* firms and participants necessitates the segregation of funds. From a Sharia perspective, this parting of funds is carried out in order to ensure that expenses and other risks, related to each fund, are allocated accordingly. Therefore, regulators are required to develop a mechanism to monitor the movement of different funds in relation to *Takaful* practices.

The importance of this regulation mechanism is obvious. Monitoring will help regulators scrutinize investment risks and expenses and reveal how *Takaful* companies allocate these in view of shareholders and policyholders rights and obligations. The expense risk, relating to the shareholders fund, should remain with the *Takaful* operator. The allocation of expenses and risks with respect to the *Takaful* fund, will depend on the model used by the *Takaful* company whether *Mudarabah* or *Wakalah*.

¹⁹⁵ Alpen Capital. (2010). *GCC Takaful Industry*. Supra footnote 131.

¹⁹⁶ Saudi joint stock market (Tadawul), available online at: <http://www.tadawul.com.sa>

2.9 SUMMARY

The main objective of Chapter 2 was to present an abridgment on the Legal and jurisprudential concept of Islamic Mutual Cooperative Insurance [*Takaful*] and its potential application in the world.

The following points were outlined in my personal reflection; motives for my choice of thesis; a brief overview of the meaning of *Takaful*; a synopsis of the global development and features of commercial insurance under the perspectives of Islamic experts; the three pillars of an insurance contract; A brief survey of *Takaful* global development, to date; an analysis and evaluation, indicating the strengths and weakness, and the problems and challenges facing *Takaful* under Islamic Sharia Law.

Chapter 3 will examine the distinctiveness of the Models of *Takaful* (*Mudarabah*, *Wakalah* (agency), and *Wakalah* with *Waqf*) and Family *Takaful*, exploring different opinions between the four schools of Islamic Sharia law.

CHAPTER 3: THE MODELS OF *TAKAFUL* (*MUDARABAH*, *WAKALAH* (AGENCY), *WAKALAH* WITH *WAQF*) AND FAMILY *TAKAFUL*; THE DIFFERENTIATION OF OPINIONS AMONG ISLAMIC SHARIA LAW SCHOOLS

3.1 Introduction

Enthusiasm for the Islamisation of banking and insurance is currently at its peak. In fact, it is clear that both private individuals, and financial institutions, are making every effort to Islamise banking and insurance sectors. The concept of insurance has existed for many centuries. Indeed, 19th Century Muslim traders came to regard insurance as a necessity, transporting their cargo via shipping goods across the seas to distant countries. These traders would mutually arrange for safeguards, covering their cargo and vessels against the risk of sinking. Over the last two decades, a new form of Islamic insurance, known as *Takaful*, has emerged. *Takaful* has been growing in popularity throughout the world, Islamic, and Non-Islamic, countries alike.

Consulting the primary sources of Islamic *Sharia* law¹, this chapter will identify *Takaful* as an Islamic provision. Hence, discussion will focus upon the jurisprudential (*Fiqhi*) issues associated with *Takaful* verdicts, as based on sound principles, synonymous with Islamic scripture. Further, the chapter will illustrate the nature of the *Takaful* contract, as a new feature within today's insurance industry. This will be followed by a *Fiqhi* analysis of *Takaful*, exploring various applications.

Based on *Waqf*, *Wakalah* – a company's method of operation/agency - incorporates numerous features and mechanisms. This study will highlight the application of these features in line with majority opinion, voiced by Islamic experts and economists, with reference to its relative advantages.

¹ Quran, Sunnah, Consensus (Ijmaa), Analogy (Qias).

As a product, family *Takaful* is an Islamic alternative to life insurance, offering a range of models and options. Therefore, this chapter illustrates these models while also describing the contractual relationship between relevant parties.

Correspondingly, there is considerable divergence with *Takaful* application; here, the concept of surplus represents a defining feature, distinguishing *Takaful* from conventional insurance. Therefore, at the end of this chapter, specific regulatory and supervisory considerations will be illustrated based on the *Takaful* system.

3.2 Definition of Islamic Mutual Cooperative Insurance (Takaful)

Takaful is an Arabic term meaning joint guarantee pertaining to a debt, and/or commitment to conservation and care. In respect of this, the Prophet Mohammed, Peace Be Upon Him (PBUH), stated; “*I, as the carer of the orphans in Heaven, will be like this*”, and indicated to his fingers, and divided them² (Holding the index and middle fingers close).

The *Takaful* contribution is basically the amount participants actually pay, or promise to pay, to a *Takaful* pool or operator. This payment is either wholly (*Wakala* concept), or partially (*Mudarabah* concept), donated form an insurance portfolio; for which an indemnity is paid when the insured risk occurs, as per the terms and conditions of the *Takaful* certificate. Thus, initially, a *Takaful* contribution is paid as a donation, adding to the insurance portfolio of all participants. Although portfolios are often managed by incorporated companies, these companies do not own participant contributions. Instead, contributions are handled on the basis of agency, or agency cum *Mudarabah*, and possibly *Mudarabah* combining *Musharaka*, as explained in the proceeding sections.

In other words, the basic objective of *Takaful* is to cover a defined loss via a defined fund. Thus, each member of the pool makes provisions to support the needy, thereby promoting mutual help among group participants. Abo Guddah (2008) held that the definition of *Takaful* is the participation of a group, bound together in a financial system, allowing members to

² Imam Muslim (H 261). Sahih Muslim, Dar Alam Al kotb 1996. Volume 4 page 2287 Hadeeth no 2983.

cooperate in shouldering injury by paying appropriate compensation to the injured through donor's premiums³.

Furthermore, *Takaful* insurance, as described by the Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI), is "a symbiotic relationship between people who may be exposed to similar dangers". This association is formed in order to avoid/reduce damage caused by those dangers members pay contributions against. Based on a commitment to donate, *Takaful* consists of an insurance fund incorporating a separate financial fund, so as to pay compensation for damages incurred by participants as a result of damages from the insured. This Financial Fund is administered either, by a select committee chosen from policy holders, or by an independent company. However, independents charge an administration fee for managing an insurance business, taking a share of the profits in return for their investment funds, hence, functioning as an agent or speculator"⁴.

Ma'sum Billah has added that "*Takaful* (Islamic Insurance) is a financial transaction of mutual co-operation created between two parties, providing financial security against unexpected material risk". In a *Takaful* transaction, the first party, referred to as the participant (insured), pays a particular amount of money, known as a contribution (premium), to the second party, known as the *Takaful* operator (insurer). At this point, it is mutually agreed that the operator is under legal responsibility to provide the participant with financial security against unexpected loss or damage incurred by the subject matter of the policy, if occurring within policy timelines.

However, in cases of *Takaful* life policies - where loss has not occurred within a specified period - the insured party is entitled to re-coup the sum of their paid-contributions held via the Participant's Account (PA). The insured party is also entitled to a share of the profits made as a result of their paid-contributions, based on principles characterised by the *al-Mudarabah*⁵

³Abo Guddah. A. *The Cooperative Insurance through Waqf system. Paper published by International Islamic University in Malaysia 2008 available online on; http://www.islamfeqh.com/15_6.pdf*

⁴ Islamic *Sharia* Standards. Published by the Accounting and Auditing Organisation for Islamic Financial Institutions. Bahrain 2007, Islamic Standard No. 26 Page 436.

⁵ *A1-Mudarabah* is a financial technique applicable to the Islamic partnership between two or more parties. In this scenario, one party provides capital while the other offers service or skill in a particular business, both sharing profits accordingly. Today, Islamic banks and insurance companies operate on the principle of

financing model. In this transaction, both the *Takaful* operator and the participant are mutually cooperating for financial protection⁶.

3.3 Takaful Operations adopt the same rules as those applied in General Contracts

Jurists are experienced at verifying certain properties or qualities necessary for the validity of contracts. Based on a number of perspectives, it is conceded that *Takaful* operations constitute a type of contract. Thus, the rules and principles adhered to within the *Takaful* contract fall under those applied to general contracts *vis-à-vis* subject matter, terms and conditions and investment requirements. When one explores the *fiqh* literature in respect of legal contracts, it becomes clear that a valid contractual relationship must include the following:

a) Exchange of Offer and Acceptance

A contract is valid when the exchange of an offer is accepted via two or more contracting parties. In this instance, it is necessary to identify the contracting parties participating in *Takaful* operations⁷. These parties - one offering and the other accepting - may be viewed from two perspectives. As far as *Takaful* membership is concerned, the act of *offer* and *acceptance* represents an exchange between those holding the *Takaful* portfolio, and potential participants. The *Takaful* operator uses an insurance license to create a *Takaful* portfolio matched to his/her/its juristic personality. The operator then acts on behalf of this juristic personality to exchange offers, pending acceptance, with potential participants. Having signed the contract of contribution, participants are then awarded membership status within the *Takaful* portfolio and are subject to the operator's article of association with regard to rights and obligations⁸.

Mudarabahh, an alternative to interest based-transactions. In brief, *Mudarabahh* is an interest free, profit and loss sharing transaction.

⁶ Ma'sum Billah. M. Developing Applications for Islamic Insurance *Takaful*. Published by ICMIF available online on: http://www.panoramassicurativo.ania.it/get_file.php?id=14523 Retrieved on 14-08-2012

⁷ Ibin Alqaeem (H751). Eelam Almuqaen. Dar Alkotob Alilmiyah Lebanon 1996, Volume 3, Page 129.

⁸ Ma'sum Billah. M (2007). *Applied Takaful and Modern Insurance Law and Practice*. Sweet & Maxwell Asia 2007. Page 238.

After establishing a *Takaful* portfolio, an implied exchange (offer/acceptance) between the operator and the members of the *Takaful* portfolio (participants) occurs regarding management of the *Takaful* portfolio. This agreement permits the operator to arrange contracts and determine contributions and indemnities on behalf of participants. The exchange also grants the operator the right to invest contributions in accordance with models adopted by the operator. Thus, the creation of a *Takaful* membership portfolio is necessary to ensure *Takaful* validity. Conversely, without juristic personality, represented by the operator, *Takaful* processes would be invalid⁹. At this juncture, it is noted that the procedures of *offer* and *acceptance* are conducted via standard forms, completed by prospective participants. Besides serving the interests of contracting parties, this practice is also acceptable within *Sharia*, being compatible with *Sharia* rules and principles.

b) Legal Competence and the Concluding of Contracts

It is essential that contracting parties, who exchange *offer* and *acceptance*, possess the legal capacity to enter into an agreement. In *Takaful*, operators gain the *legal capacity* to conclude contracts by virtue of their license of operation. Whereas, the participants' fund derives *legal capacity* from the assumed status of the operator, who represents and manages the *Takaful* fund¹⁰.

c) Determination of the Subject-matter

The formalities of a valid contract require that the subject matter be defined clearly. The subject-matter can take the form of tangible goods, services and/or usufructs. In *Takaful*, relationships differ according to subject-matter. As far as fellow participants are concerned, the subject matter of *Takaful* is essentially cooperation between a group of people vulnerable to similar/common risk, aiming to minimise the effect of that risk via *Takaful* contributions.

In this context, the subject matter may be explained as follows¹¹:

⁹ Husain Hamid. H "al-Ta'min Ala al-Hayat", *Hawliah Albaraka*, December 2000, pp. 38-69. Mohammed Burhan Arbouna. *Regulation of Takaful Business: A Shari'a Overview of Contractual Aspects of Takaful Models*. Unpublished Article. p13.

¹⁰ Khoder. M (1994) *Saudi Commercial Law*. Aldar Alwatania Aljadeeda for publishment. Alkhobar, Saudi Arabia. P 147

¹¹ Albadrawi. A. (1963). *The Insurance*. Wahbah for publishment. Cairo. p61. Alsalih. M (2004) *Insurance between Permission and Prohibition*. Al-Obiakan for publishment. Riyadh. p65.

(i) The amount of contribution paid by participants constituting mutual cooperation between members. This premium may be paid in a lump sum or as set instalments during the period of *Takaful*. As the participant contributes to the fund this qualifies him/her to become a member. Membership is on the understanding that participants accept certain procedures relating to their donation and to other members, if/when the insured risk occurs. By making this contribution, members establish a *Takaful* portfolio/fund, distinct from the capital of the *Takaful* operator. Therefore, in order to become a member, the participant is entering into a contract with the operator who represents the *Takaful* fund.

(ii) The indemnity amount paid by the operator, on behalf of the participants, to a member incurring the insured risks. As far as the operator and the underwriter are concerned, the subject matter involves providing services along with the payment of fees, if any. In terms of investment, the subject matter represents either, the payment of fees and provision of services or, work and a percentage of profit. However, this depends on the model of investment used by the *Takaful* operator in view of the *Takaful* fund. Thus, the validity of the *Takaful* system hinges on a clear understanding of the subject matter. Hence, *Takaful* agreements, and participation, must reflect various subject matter in order to be valid and free from ambiguity.

d) The *Takaful* Operation must be Beneficial to all Contracting Parties

The *Sharia* requires that contracts are concluded on the understanding that they benefit all parties. This is because a contract portrays an exchange of interest and it is not practical to agree on something that gives no immediate benefit to the contracting parties. In Islamic law, contracts must serve the interest of two parties equally. Each party must feel that he or she has benefited from the contract. However, if a contract benefits only one party at the expense of the other, the contract becomes void¹².

e) The *Takaful* Operation must not Contradict an Explicit Text

To preserve the validity of *Takaful* operations, it is important that the general features of a *Takaful* model are not fashioned in a way that conflicts with sources explicit to the *Qur'an* and

¹² Ibin Alqaeem (H751). Supra footnote 8 Volume 4 page 201. Albahooty. M (H1051). *Kashaf Alqinaa. Kitab-u-Alshirkah*, Dar Alaam Alkutub 1997 Lebanon, Volume 3 page 180.

Sunnah. If a source does impact in such a way that certain structures are not possible, then the product that depends on this structure becomes unacceptable in *Sharia*¹³.

f) Observation of Impermissible Transactions

A *Takaful* product must not be intended to circumvent impermissible transactions, such as *riba* and *gharar*. If the structure appears to involve *riba* or *gharar* in a roundabout way, it then becomes unacceptable¹⁴. One of the basic differences between *Takaful* and conventional insurance is the way the investment of funds is managed. In *Takaful*, agreement and investment mechanisms must comply with Islamic principles. Further, no investment should be made in non-*halal* products. Moreover, the *Takaful* fund and operators capital should not be invested in interest-based transactions.

3.4 Features of Islamic Insurance (Takaful)

It should be noted that the *Takaful* concept aims to provide policyholders with the same services offered by conventional commercial companies. The theme of *Takaful* is to protect participants against the inability to overcome unwanted future events and difficulties. Nevertheless, this objective is achieved via a completely different set of features. The most important features of Islamic insurance can be summarized as follows¹⁵:

a) Islamic insurance companies strictly observe *Sharia* rules and principles. This relationship is built on the avoidance of *riba*-based transactions, especially when investing collected contributions. Again, contracts and policy certificates must comply with the requirements of *Sharia* in respect of agreement. Basically, it is not a requirement that a particular *Takaful* contract, activity or relationship should comply with a *Sharia* nominated contract, or that a *Takaful* contract must exist in the *Qur'an* and *Sunnah*. All that is required is that the contract

¹³ Ma'sum Billah. M(2007). Supra footnote 9. P238. Dr. Biltaji. M. The Insurance Contract in Perspective of Islamic Jurisprudence. Published by the Scientific Encyclopedia of Banks. 2004 Volume 5 p137.

¹⁴ The High Committee for *Iftaa* in Saudi Arabia Resolution no.(18332) on 25/11/1426H available online at: <http://www.alfalaq.com/sam/sam121.htm>

¹⁵ El Qora Daghi.A (2006), Islamic Insurance, El Bashaer Islamic Press. p134. Sharaf al-Din. Ahmed (1983). *The Verdicts of Insurance in Legal and Judiciary Terms*. Kuwait University Edition. p 125

must not violate *Sharia* principles. In fact, as a general principle, all contracts concluded by men are considered valid unless explicitly prohibited by *Sharia*. This feature of *Takaful* necessitates the appointment of *Sharia* Boards and internal *Sharia* Advisors in order to guide how insurance processes should be carried out in light of *Sharia* requirements.

b) The formation of two separate accounts at the signing of the insurance policy. One account manages the movement of funds governed by shareholders. The other, manages the movement of funds belonging to individual participants. Here, it should be noted that this segregation also creates a partnership/relationship between participants and operators as illustrated below.

c) In principle, the relationship between the operator and the participant is either an “agency-agency” relationship or an “agency *cum Mudarabah*” or an “agency *cum Waqf*” relationship¹⁶. In other words, the insurance company is authorised by participants to manage operations and insurance services including, among other things, the preparation of documents, the collection of contributions and the payment of indemnities. Participants also authorise the company to invest their mobilised contributions, either on the basis of investment agency and/or *Mudarabah*, in accordance with the terms and conditions agreed upon by all parties.

d) An Islamic insurance company endeavours to meet the objectives of cooperation and solidarity among policyholders. This is achieved through payment, where participants offer a premium or contribution on the understanding that this amount is donated, in whole or in part, to remedy damage or catastrophe befalling any registered member within the insurance portfolio. Therefore, the donated sum belongs to all participants and does not belong to shareholders, as in the case of conventional insurance companies.

e) Islamic insurance involves uncertainty pertaining to compensation and its value. This affects the exchange contract, but not the donation-based contract, which is the basic philosophy of *Takaful*. In Islamic insurance, uncertainty or *gharar* occurs between participants who constitute one entity to meet mutual benefit. Alternatively, in conventional insurance, the

¹⁶ Ma'sum Billah. M(2007). Supra footnote 9. Pp.18-29.

gharar is between the insured person(s) and the insurance company¹⁷. These are two separate parties whose interests conflict. In conventional insurance, the *gharar* lies with the fact that a person is paying a premium for an indemnity regarding an insured risk, which may or may not happen.

f) Islamic insurance companies distribute the accumulated surplus to participants according to their contribution. The surplus is calculated as contribution minus compensation, expenses and reserves¹⁸.

g) In the ideal situation, *Takaful* participants contribute additional money to protect against deficit when meeting the insured risk¹⁹.

h) Policyholders are entitled to participate in the administration and supervision of all *Takaful* operator activities. This participation may be achieved by the creation of an Association of Participants (AP). The AP can appoint a representative to attend management meetings or board meetings on behalf of participants. This participation can help to overcome the problems associated with the mutual exchange of loans between *Takaful* operators and participants, should the operator choose to operate on this basis²⁰.

3.5 The Jurisprudential (*Fiqhi*) Analyses of Takaful Verdicts

There is considerable interest among insurance industry specialists concerning *Takaful* as an appropriate solution. In recent times modern Islamic experts have considered *Takaful*, as an alternative to conventional insurance products because it is free from unlawful elements such as gambling, *riba* (usury) and other uncertainties. All the same, a considerable number of

¹⁷ Algari.M 2009. *Al fai'id Altaaminy*. An Arabic paper presented at the cooperative insurance conference in Riyadh. P16 available online at: <http://iifef.com/files/taameen/03.pdf>

¹⁸ Haidar.H (2009) *Al fai'id Altaaminy*. An Arabic paper presented at the cooperative insurance conference in Riyadh available online at: <http://iifef.com/files/taameen/08.pdf>

¹⁹ Manjoo. F. (2007) Risk Management; A *Takaful* Perspective, Published by Alnoor 2007 Kensington, South Africa.

²⁰ *Awards and Recommendations of Nadwat al-Baraka al-Iqtisad al-Islami*, 2001, p.156.

experts believe that certain *Takaful* models, advocating contemporary formulations, include elements which deem them non-compliant with Islamic *Sharia* teachings.

Contra to the above-mentioned, there are also a number of Islamic experts who assert that *Takaful* complies with *Sharia* law and is in line with the *Quranic* doctrine of co-operation. Furthermore, these experts believe that *Takaful* follows the Holy verse where *Allah* commanded to all believers: “*Help ye one another in righteousness and piety, but help ye not in sin and rancor: fear Allah: for Allah is strict in punishment*”²¹. This verse is considered a general rule by jurisprudential scholars; thus, under Islamic teachings, the commandment to practice mutual co-operation is not an absolute. On the contrary, there is a limitation to it, as *Allah* has further prohibited mankind from mutually cooperating in any manner involving sinful element. Furthermore, in proof originating from the *Sunnah* doctrine; Jabir bin 'Abdullah narrated that:

*“Allah's Apostle sent an army towards the east coast and appointed Abu 'Ubaida bin Al-Jarrah as their chief, and the army consisted of three-hundred men including myself. We marched on until we reached a place where our food was about to finish. Abu 'Ubaida ordered us to collect food for the journey, and it was collected. My (our) food consisted of dates. Abu 'Ubaida gave us our daily ration in small amounts until the store was exhausted. Our share had amounted to one date for each of us. I said, "How can one date be of benefit to you?" Jabir replied, "We came to know the value of this when even that finished." Jabir added, "When we reached the sea-shore, we saw a huge fish which was like a small mountain. The army ate from it for eighteen days. Then Abu 'Ubaida ordered that two of its ribs be fixed, and they were fixed in the ground. Then he ordered that a she-camel be ridden to pass under the two ribs (forming an arch) without touching them”.*²²

Another witness from *Sunna* narrated by Abu Musa Alash'ari suggested that the Prophet (Peace Be Upon Him) stated:

²¹ Ali. Y. Translation of the Holy Quran. Almaeda chapter 5. verse 2 Available online at: <http://www.usc.edu/dept/MSA/quran/005.qmt.html>

²² Imam Bukhari(810) *Sahih Bukhari*, Volume 3, Book 44, Number 663 available online at: <http://www.jannah.com/cgi-bin/library/hadeeth.pl?coll=1&book=44>

“When the people of the Ash’ari tribe ran short of food during the holy battles, or the food of their families in Medina ran short, they would collect all remaining food in one sheet and distribute it among themselves equally by measuring it with a bowl. So, these people are from me, and I am from them.”²³

Objections:

Many modern day experts consider the above *Sunna* witness accounts as direct inspiration for the concept of *Takaful*. On the other hand, critical differences exist between the above recorded events (stories) and *Takaful*. These are as follows:

1. According to previous scholarly opinion; the above Ash’ari event is considered an extraordinary case relating to times of poverty or extreme need, to food in travel or to holy battles. Ibin Hajar²⁴ has remarked that the quotation “ran short of food”, suggests that these actions were carried out as a donation in the spirit of console and tolerance and in preference of doing good to others. Hence, this is different from *Takaful* since mutual application applies in different circumstances. The above event also applied to all persons in need, and was not restricted to participants only.

In terms of modern expert opinion; current enthusiasm for the Islamisation of banking and insurance is at its peak. Both private individuals and financial institutions are making every effort to Islamise banking and insurance sectors. Thus, the present situation is perhaps not so far removed from the analogy of an extreme need for food as mentioned above. Nowadays, Islamic finance can arguably grant people a safe financial life in an arena where people’s social lives are complicated, and ignorance and poverty are evident. Potentially, *Takaful* is a commercially viable institution appropriate for future money markets.

2. Previous scholarly opinion: Upon considering the two conditions mentioned above, the difference between what a person is paying and what he/she is taking is usually tolerated when conducted in a prescribed manner. Hence, Albahooty justified

²³ Imam Bukhari(810)*Sahih Bukhari*, Volume 3, Book 44, Number 666 available online at:

<http://www.jannah.com/cgi-bin/library/hadeeth.pl?coll=1&book=44>

²⁴ Ibin Hajar. A (H 852). Fath-u-Albari, Kitab- u- Alshihah, Egypt Dar 2001, Volume 5 page 181.

*Almunahadah*²⁵ as lawful in Islamic *Sharia* because it is based on forgiving. Albahooty, stated: “in travel, *Almunahadah* is completed by the righteous. Indeed, Al-Hassan did this when he traveled with his companion”²⁶. Nevertheless, this concept differs from the model of *Takaful*, where the difference between persons paying and gaining may reach highly significant monetary proportions. Hence, from this perspective, *Takaful* it will not be tolerated and does not comply with events described in *Sharia*.

Modern expert opinion: Dr M. Biltaji²⁷ (2004) held that while the primary purpose of a group of people participating in their own shares is based purely on cooperation and solidarity, as well as necessity, so it may then be acceptable to participate in equal/unequal shares, as in *Almunahadah*. If this is available under circumstances of famine or travel, as it is in Ash’ari and Abu Ubaida. Thus, in all cases the settlement allowed for them is what they are permitted to receive.

3. Previous scholarly opinion: From the above Ash’ari story, the prophet Muhammad (PBUH) described how the hungry “...distributed food among themselves equally”. As a result, S. Allhiani ²⁸ (2006) held that even when one individual did not have anything to contribute, the division, according to the above text, must be equal. This means that each person receives an average award, differing from *Takaful* where compensation is awarded to a policyholder and is related to a potential risk, which may or may not occur. In short, these features make *Takaful* different from Ash’ari. To explain, the payment of money is a pure donation in Ash’ari, but this is not the case in *Takaful* since the *Takaful* contract appears to be a contract of exchange (*Muawadah*). Therefore, in cases where a claim is made, if the company fails to provide the participant with suitable compensation, the participant will not hesitate to sue the company, and hence the concept of donation is lost.

²⁵*Almunahadah* is a type of company when a companionships place all of their food in one sheet and then distribute it among themselves equally.

²⁶ Albahooty. M (H1051). *Supra* footnote 13. Volume 3 page 189.

²⁷ Biltaji. M. *supra* footnote 15, Volume 5 p137.

²⁸Allhiani. S: *Ash’ari story is proof of why we should allow insurance*. Paper published by King Abdul Aziz University. 2006 available online at; http://islamiccenter.kau.edu.sa/arabic/Hewar_Arbeaa/ABS/209.htm

4. The modern expert opinion of Y. Shubaily ²⁹ (2008) confirms that the *Takaful* contract is a cooperative contract, as opposed to a contract founded purely on donation or exchange (*Muawadah*). Having said this, there are numerous similarities amongst certain procedures which create confusion. Differences between each of the contracts are described further on.

In addition to the above, M. Ma'sum Billah³⁰ (2007) likens the base of *Takaful* to “The acceptance of the old Arab's practices of ‘*Aqila for Dyat*’”. In addition, the Prophet Muhammad (Peace Be Upon Him) himself has accepted the concept of *Aqila*'s practiced by the old Arab tribes. However, in Islamic Jurisprudence, use of the term *Aqila* is limited to the males of the tribe, and in the case of blood money (*dyat*)³¹ men must pay, thereby sparing the females from doing so. However, the *Takaful* model is based on exchange between both genders. The general concept of mutual exchange is found in many other examples in Islam *Sharia* i.e. *Zakat* etc. To support this, A. Abo Guddah³² (2008) added that *Takaful* is based on considered legitimacy and rules, which include the following:

- Bringing benefit and pushing away harm;
- The damage is pushed back as much as possible;
- There is evidence to support social cooperation.

In addition many other provisions of *Sharia* attain solidarity, such as *zakat*, expenditures, ‘*Aqillaa for Dyat*’ and so on. After these *Fiqhi* analyses, the question arises as to whether *Takaful* complies with Islamic teachings. In order to learn via reaching a conclusion, one must analyse the nature of *Takaful* contracts.

²⁹Shubaily.Y. A comparison between the *Waqf* and *Takaful* system. Paper published by International Islamic University in Malaysia 2008 available online at; http://www.islamfeqh.com/15_4.pdf

³⁰Ma'sum Billah. M. *Developing Applications of Islamic Insurance Takaful*. Supra footnote 7.

³¹Ibn qudamah Almaqdisy (1223AC) (620H). *Almugnee*, Dar Alkutub for publishing, edition 3, 1997, Beirut. Volume 15 page 39.

³²Abo Guddah. *Cooperative Insurance through the Waqf System*. Supra footnote 4.

3.6 The Nature of Takaful Contracts

There is considerable discussion among modern experts concerning *Takaful*, and to what extent this system is applicable to:

1. A pure donation contract or
2. A cooperative mutual contract or
3. A contract of exchange as a form of conventional insurance.

In order to obtain a clear answer, it is important that each type of contract be described.

3.6.1 IS TAKAFUL PURELY A CONTRACT OF DONATION OR IS IT A QUALIFIED CONTRACT OF DONATION?

The application of *Takaful* confirms that this model is not purely a contract of donation because, essentially, the nature of donation is based on a contract of payment. Here, the participant pays without expectation of reward or compensation. Alsharief. M (2008) asserted that the donation must be devoid of compensation and profit. So, in the majority of *Fiqhi* schools, a gift (*Hibba*) or donation accompanied by conditions of compensation is considered a sale thus, all provisions of sale will apply to it. For example, the defect option (*kheyar al'aaib*) and the option of description (*kheyar alwasf*)³³ are applicable. Likewise the High Committee for *Fatwa* in Saudi Arabia confirms that only commercial insurance policy holders receive profit from trade. However, this is not applicable to mutual cooperative insurance hence marking it distinction from the former³⁴. The *Takaful* model confirms that the participant pays money in order to impose their right to receive compensation.

Represented by Alhattab, the Maliki School have also put forward a point of view regarding qualified donations and their application in the *Takaful* contract. As a new concept and form, the payment contribution is based on the principle of “unilateral binding undertaking to donate”. Endorsed by the Maliki School, this perspective is expressly illustrated in the following sections.

³³Alsharief. M (2008) *The Islamic Alternative to Insurance*. Paper published by International Islamic University in Malaysia 2008 available online at; http://www.islamfeqh.com/15_5.pdf

³⁴ The High Committee for *Iftaa* in Saudi Arabia Resolution no.(18332) on 25/11/1426H available online at: <http://www.alfalaq.com/sam/sam121.htm>

3.6.1.1 Issues associated with the Donation Relationship

It has already been established that *Takaful* processes operate largely by virtue of the contract of donation. In this case, following their withdrawal, participants should not be entitled to a return or a share in surplus and profit. This is because a donor is discouraged by Prophet Mohammed's statement (*Hadeith*) to call off a donation, as it is considered to be a gift (*Hibbah*) once paid. To this effect, Ibn 'Abbas has quoted the Prophet stating that, "...one who takes back his gift (which he has already given) is like a dog that swallows its vomit."³⁵

In order to discourage such action, calling off a donation is viewed as being similar to a person who feeds on their vomiting; such a comparison suggests that calling off a donation is a filthy act. This principle calls for an evaluation of the concept of donation in *Takaful*. Here, the latter should be carried out in respect of principles evoked in order to justify the entitlement of participants to receive surplus, reserves and/or any other mode of compensation³⁶.

3.6.1.2 Rulings of Conditional or Qualified Donation

The execution of an Islamic insurance contract, on the basis of donation, is often evident when the insured waive all, or part of, their instalments for the benefit of other participants. This issue has prompted commentators of Islamic insurance to suggest that the surplus should be distributed to participants serving as a remainder of their *Takaful* donations. This, in turn, raises legal questions as to whether members are entitled to donate, and later receive part of their donation, for example, when there is a surplus or when the operator cancels the policy, for whatever reason.

At this juncture, an investigation of *Takaful* principles may result in awarding donors the right to receive part of their donation back. In other words, is it permissible for a donor to qualify their donation whereby the donation is only effective when the qualification is realised? In addition, is it possible for a donor to state this amount as a donation if the entire amount is disbursed to the beneficiaries. However, if only part of their donation is disbursed should the remaining sum be reimbursed?

³⁵ Imam Albukhari (810) *Sahih Albokhari. Gifts Book. Volume 3, Book 47, Number 762. Available online at* http://www.usc.edu/schools/college/crcc/engagement/resources/texts/muslim/hadith/bukhari/047_sbt.html

³⁶ Alsalih. M (2004) *Insurance between Permission and Prohibition*. supra footnote 12. p77. El Qora Daghi.A (2006), *Islamic Insurance*. Supra footnote 17. P65

Answers to the above questions require us to recall the basis of *Takaful* operations. It is noted that the *Takaful* model is based on organised donation distinct from any *Sharia* nominated contract of donation. The *Takaful* contract combines elements of generosity (*tabaruu al-mukarama*) and reimbursement (*mu'awadah*). In Islamic law, this form of donation may be circumscribed with a qualified condition. Therefore, the contribution of participants is implicitly qualified to extent of use. This implies that, at the date of contribution, members are not entitled to part of their contribution in situations where contributions are used to indemnify beyond any surplus amount. However, where surplus exists, it must be distributed to participants. Thus, by default, the *Takaful* contract holds the sum total contribution as a donation throughout the extent of the claim. If claimants are paid and there is still surplus, such surplus should not be considered a donation, but rather a right that should be returned to participants. This is a form of qualified donation³⁷.

In principle, this qualification does not affect the contracts of donation. This is because *Sharia* allows that donations be restricted by conditions, allocated for a specific purpose or to be a contingent in certain events. In brief, the characterisation of *Takaful* contributions as donations does not contradict the idea of reimbursement of the remaining surplus. Contributions may be partly reimbursed in cases where the certificate is cancelled by the operator for justifiable reason and/or under the availability of surplus.

The conditional donation has a precedent in Islamic law under the concept of the *umri* contract. Here, a gift for compensation or *hibah althawab* was endorsed by many schools of Islamic law such as Abo hanifa, Malik and other scholars³⁸. At this stage, it should be noted that the term 'gift' in Islamic law is classified into two forms, namely absolute gift or *hibah mutlaqa* and compensatory gift, i.e. a gift with the aim to be compensated later. This is known in *fiqh* literature as *hibah al-thawab*. By definition, a qualified gift is also a contract of donation³⁹. Again, the Prophet (Peace Be Upon Him) is reported to have sent a gift to Najashi, the king of Abyssinia, on condition that the gift belong to Najashi so long as he is alive. The

³⁷Algari. M 2009. *Al fai'id Altaaminy*. Supra footnote 19.

³⁸ Ibn Rushd Alhafaed.(595H).Bidait-ul-Almujtahid. Ibn hazim for publishing (1999). Cairo. v2. p269.

³⁹ For more on qualified, charity-based contracts, see Qahf. Munzir, *al-Waqf al-Islami*, (Beirut: Dar al- Fikr, 2000), pp. 137-142.

Messenger found that Najashi was dead and the gift was returned to the Prophet (Peace Be Upon Him); he received it and distributed it among his wives.⁴⁰

3.6.1.3 The Obligatory Nature of the Takaful Donation

It has been established that *Takaful* is based on a contract of donation. However, there are a number of donation contracts in Islamic law, e.g. ordinary alms giving, agency, loan, unqualified gift, and will or *wasiyyah*⁴¹. In broader terms, the phrase *tabarru* or donation constitutes the disbursement of wealth, rendering services and work without monetary consideration but with hope for reward in the hereafter. In other words, the immediate benefit of the donation goes to the beneficiary and the donor does not expect *ab initio*/ any financial compensation. The question thus is whether the *takaful* operation falls within this definition of donation. This necessitates explanation of the nature of donation throughout *Takaful* business, including whether it is comparable to other contracts based on payment and donation. Most of the rules and the relationships pertaining to *Takaful* depend, one way or the other, on the nature of the donation involved. As mentioned, there is no doubt that *Takaful* is based on the concept of donation. However, the *Takaful* donation is a unique form of donation. As al-Darir puts it, “the parties to this contract (*Takaful* contract) do not aim for profit in isolation. Their intention is to cooperate with the purpose of overcoming misfortunes in life. This is a special donation/contract which has no parallel to *Sharia*-nominated donations and contracts”⁴².

The uniqueness of the *Takaful* donation lies in the fact that the payment of contribution is based on the principle of “unilateral binding undertaking to donate”, espoused by the Maliki school. In principle, a donation is offered on a courtesy basis and does not signify a binding task. However, the nature of a participant’s contribution to the *Takaful* fund represents a special undertaking which is close to a binding obligation. This is due to the fact that each individual expects to participate and to rely on the undertakings of the other participants. Perhaps this is why the Maliki School entitles beneficiaries, of this form of unilateral undertaking, to bring a legal case against a donor (who promises to donate) for cancellation of their donations. Al-Hattab argued that:

⁴⁰ Ibn Hajar, *Fath al-Bari*, supra footnote 26, vol. 5, p. 222; al-Shawkani, *Nayl al-Awtar*, vol. 6, p. 100.

⁴¹ For more on donation contracts see Ibn qudamah Almaqdisy (1223AC) (620H). *Almugnee*, supra footnote 33, Volumes 15, 16, 17.

⁴² Al-Darir, Muhammad al-Ameen (1990). *Alghara Waatharoh fi Alokood fi Alfiqh Alistami*, Salih Kamil, a series for academic theses, Jeddah, edition 2(1995), p. 643.

“The Maliki jurists differ in opinion in relation to contracts in which a person undertakes to pay, if the creditor’s expected right is not paid on time, an amount of money in favour of either a third party or a charity for underprivileged persons. It is generally considered that this undertaking cannot be enforced by the courts. Alternatively, Ibn Dinar has asserted that ‘this undertaking may be enforced by the courts’”⁴³.

Discussions of al-Hattab concerning voluntary, or charitable, undertakings indicate that some Maliki jurists, notably Ibn Nafi, share similar views as Ibn Dinar. Ibn Dinar observed that numerous documents of sale/contracts have been formulated on the basis of this type of undertaking; although the prevalent view goes against their enforceability in court⁴⁴.

Views adopted by these Maliki scholars have led to the acceptance of a binding donation which can be enforced by any court of law. This is the stance adopted by the *Sharia* Board working within the Jordan Islamic Insurance Company⁴⁵. In contrast, the majority of Hanafy Shafiee and Hanbaly scholars do not accept these explanations since, as mentioned before, in principle, donations are offered on a voluntary basis and are not a binding undertaking. As such, how can the Maliki School audaciously force donors to pay when his/her involvement is only a matter of courtesy as opposed to an obligation?⁴⁶

Furthermore, this suggests that the operator is also responsible for ensuring that the participant, who promises to pay a donation, has actually paid the donation and that this is procedurally reasonable. Nevertheless in instances where the participants did not pay, then the operator is responsible for bringing the case to court and for payment. So, in order to affect this policy, contracts must clearly state this fact to participants.

⁴³ al- Hattab, *Tahrir al-Kalam fi Masa’il al-Iltizam*, Islamic West House for publications, Lebanon edition 1(1984) p176. See also Algari.M 2009. *Al fai’id Altaaminy*. Supra footnote 19. Alsalih. M (2004) *Insurance between Permission and Prohibition*. Supra, footnote 12.p77.

⁴⁴ *Ibid.* p. 171

⁴⁵ Unpublished *Fatwas* on Insurance Practices by Jordan Islamic Insurance Company.

⁴⁶ El Qora Daghi.A (2006), *Islamic Insurance*. Supra footnote 17. P65. Biltaji. M. supra footnote 15. Volume 5 p132.

3.6.2 IS TAKAFUL A MUTUAL COOPERATIVE CONTRACT, OR IS IT A CONTRACT OF REIMBURSEMENT?

Before answering this question, it is essential the reader understands the features of a contract of Reimbursement.

3.6.2.1 The Features of Contract of Reimbursement (Muawadah)

The contract of Reimbursement has been mentioned several times nevertheless, greater understanding of its features is perhaps vital to the reader because of its critical affect upon insurance and the *Takaful* contract. One clearly defined perspective on the contract of reimbursement (*Muawadah*) in *Takaful* focuses on the mutual relationship. In its application, one party pays in order to insure anticipated compensation when he/she needs it. Therefore, we should apply the follow conditions to make all transactions Islamically lawful:

- The contract must be free of *Riba* (interest). *Riba* appears when a transaction in a *Takaful* operation involves monetary exchange. In fact, Zohaily. W⁴⁷ has provided us with a good example. In this scenario, the participant pays money, called a premium, and in return, the *Takaful* company pay out money referred to as compensation. Cases where one party receives more money than was paid, tend to be considered *Riba Fazil and Riba Naseeea*. However, if compensation equals what was paid, then it is considered to be *Riba Naseeea*.
- The contract of reimbursement must be free of *Gharar* (uncertainty) which leads to disputes. The Prophet Muhammed (Peace Be Upon Him) forbade *Gharar*.⁴⁸ *Takaful* can be analogous to *Aqilah* or the Ash'ari tribe applications described earlier, because
 1. These models perform their contributions in the form of a donation contract rather than a contract of reimbursement (*Muawadah*).
 2. In *Aqilah*, the duty of compensation falls on the tribe when an individual compensator has no financial capacity to pay, this is considered a donation also.

⁴⁷ Zohaily. W. Insurance and Re-insurance. Dar alfiker Lebanon 2003 Page 550.

⁴⁸ Imam Muslim (H 261). Sahih Muslim, Dar Alam Al kotb 1996. Volume 3 page 1153 Hadeeth no 1513.

- The contract of reimbursement must be free from ambiguity, and the subject matter (*mahalual aqad*) must be definite. Zarqa. M ⁴⁹ (1998) held that throughout the contract of exchange, if ambiguity leads to dispute, then the contract will be rendered invalid. This detail is not quite clear in terms of the application of *Takaful* – typically, the participant does not know how much he/she will pay (he/she will probably pay for one, two or three years longer than initially expected). An individual may also be ignorant as to what extent he/she will be covered – with compensation values remaining exceptionally high. Therefore, scholars remedy this by establishing the *Takaful* contract based on a donation which it is not affected by ambiguity.

Thus, if we apply the above-mentioned conditions to the cooperative insurance contract, we will clearly find that this type of agreement does not contain all of these conditions. Islamic cooperative insurance/*Takaful* was established, based on contracts of donation which the above conditions do not affect.

3.6.2.2 Analysis regarding the Nature of Takaful Contracts

The opinion of Shubaily.Y (2008), confirms that the cooperative insurance contract represents a contractual relationship between two or more parties involved in loss and profit. The contract takes three forms; an agreement for the sake of profit, as in company contracts, an agreement to reduce the expenses as found in *Almunahadah* including the travellers scenario, and finally, an agreement to reduce damage and harm, as in *Takaful*. In contrast, Shubaily. Y (2008), stated that the contract of reimbursement is based on a quarrel between parties, where inevitably, one loses and another wins. Much like conventional insurance, where a relationship between the company and the policyholders is classed as an exchange relationship. Here, compensation reduces as surplus increases thereby the company wins and vice versa⁵⁰. However, Alsharief. M (2008) voiced that there is no difference between conventional insurance and cooperative mutual insurance/*Takaful* because all clearly include the element of exchange (*Muawadah*). Alsharief. M (2008) explains that the policy holder applies to the insurance company in order to receive compensation from the fund. Yet, if he/she has doubt about the receipt of compensation, that individual need not apply. Further, he/she essentially

⁴⁹ Zarqa. M (1998) The General Fiqhi Entrance. Dar Alqalam. Damascus. 1998 volume1 page 742.

⁵⁰ Shubaily. Y. A comparison between the *Waqf* and *Takaful* system. Paper published by International Islamic University in Malaysia 2008 available online at: http://www.islamfeqh.com/15_4.pdf

applies because compensation is restricted among policy holders⁵¹. The most prominent perspective highlights, not the relationship between the company and policy holders, but the relationship between policyholders themselves. In relation to this, Sheikh A. Ibn Muneer argues that there is no difference in cases of compensation/obligation between commercial insurance companies towards policyholders and/or the obligation between policy holders themselves. With mutual cooperative insurance in order to pay compensations, both contracts have the reimbursement formula⁵².

On the other hand, in any insurance transaction, be it Islamic or conventional, premium mobilisation forms an integral part of operations. This is because premiums are core to the insurance business and *Takaful*. Al-Darir (1995) explains that in conventional insurance, the contract is based on the principles of exchange of interest. The relationship is designed in such a way that the insured buys protection via payment of premiums and the insurer provides protection against the insured risk. In this way, the contract becomes a form of sale centred around an uncertain event for which it is not compatible with Islamic principles of exchange. Instead, this form of premium contribution involves great uncertainty that invalidates contracts and financial transactions. In other words, the relationship between the insurer and the insured party is similar to that of a buyer and seller.

From an Islamic law perspective, Insurance transactions cannot be concluded on this basis. This situation demands exploration of another relationship, allowing us to achieve the objectives of the insurance business without contravening Islamic principles as applied to contracts and trade. This confirms that participants pay contributions by mutual agreement in order to indemnify the insured against peril when it occurs. A concept is based on the principles of donation which tolerate elements of *gharar* and ambiguity. All the same, these invalidating elements do not affect contracts of charity, including the ideas behind *Takaful*.⁵³

Thus, the validity of *Takaful* operations requires the mutual assistance of participants, clearly translated into practice via stating explicitly that participants contribute premiums to the

⁵¹ Alsharief, M (2008) *The Islamic Alternative for Insurance*. Paper published by International Islamic University in Malaysia 2008 available online on; http://www.islamfeqh.com/15_5.pdf

⁵² Ibn Muneer, A. Insurance between Allowance and Prohibition. Arabic lecture available online at: <http://tdwl.net/vb/showthread.php?t=5111>

⁵³ Al-Darir, Muhammad al-Ameen. Supra footnote 44, p. 643.

insurance company, as donations, in order to indemnify the insured risks. The philosophy of donation altered relations between participants and operators. These dynamics developed from premium payment in exchange for indemnity to management and investment relationships, as explained throughout the next few paragraphs. This cooperation relationship also created other relevant relations among participants. Therefore, we can distinguish *Takaful* from conventional insurance.

It is clear that:

- 1) *Takaful* cooperative insurance represents a qualified contract of donation (which has no exchange) because the element of uncertainty affects the contract of reimbursement (*Muawadah*).
- 2) There are recognised differences in procedure between *Takaful* cooperative insurance and commercial insurance.
- 3) Both employ an insurance operator (insurer, insured, risk, and premium).
- 4) The principles of donation tolerate elements of *gharar* and ambiguity. This feature renders the *Takaful* system different from conventional insurance with principles based on exchange⁵⁴.
- 5) Contracts have a bearing on actual commercial actions and are not produced solely for the sake of wording policies. Ibn Alqaeem stated that contractual considerations refer to purpose before words. Thus, the act of donation is an affective factor throughout these transactions⁵⁵.
- 6) In the author's opinion, the only application of *Takaful* which completely complies with Sharia, and receives no objections among Islamic experts, is the *Takaful* with *Waqf* model, clarified later via the illustration of *Waqf* model⁵⁶.

3.6.2.3 The Legal Relationship of Compensation between Parties

We often hear or read that *Takaful* operation is a contract undertaking to pay compensation to the insured. For this reason, some scholars argue that the obligation to indemnify, or *al-iltizam*

⁵⁴ To gain more knowledge read Alsharief. M (2008) *The Islamic Alternative to Insurance*. Paper published by International Islamic University in Malaysia 2008 available online at; http://www.islamfeqh.com/15_5.pdf

⁵⁵ Ibn Alqaeem (H 751). *Eelam Almujaqqeen*. Supra 8, V 3 page 129.

⁵⁶ See page 38- 41.

bi alta 'weed, makes *Takaful* similar to conventional insurance. Also, it should be emphasised that there is little doubt concerning the endeavour to indemnify exists within *Takaful* operations. Nevertheless, we must ascertain whether this undertaking is between the *Takaful* operator and participants or whether it is confined to participants only. A number of writings confuse the relationships involved in *Takaful*. For example, in *Takaful*, participants are simultaneously both the insured and the insurer. Moreover, participants jointly cooperate to compensate risks incurred by one participant from their paid or accrued contributions. In this case, the participants implicitly take it upon themselves to increase their contributions to meet deficits. Hence, if members do not increase their contributions, there will be no fund and so, no indemnity since indemnity is formed in accordance with the *Takaful* fund. Also, the operator was not obliged to indemnify participants, and if indemnification occurred, then *Takaful* becomes conventional insurance which has been prohibited by resolution of the International *Fiqh* Academy, as per the principles of *Sharia* in respect of contracts of reimbursement⁵⁷.

⁵⁷ The High Committee for *Iftaa* in Saudi Arabia Resolution no.(18332) on 25/11/1426H available online at: <http://www.alfalaq.com/sam/sam121.htm>

3.7 The Nature of the Legal Partnership/Relationship between Parties

Not only does the insurance industry provide administration of insurance pools. The money collected, is channeled into various lucrative investment vehicles. From this perspective, and in the case of *Takaful*, the organised form of donation consists of a partnership element between participants in respect of investment. With *Takaful*, each are entitled to a share of the profits. Investing money either on the basis of agency or *Mudarabah* is based on the concept of profit sharing. This is evident in view of the fact that surplus or profit is shared in proportion to individual contribution; a *Takaful* relationship often omitted by commentators writing about Islamic insurance. Therefore, one may humbly conclude that the relationship of participants between peers involves a combination of donation and partnership (*musharaka*). Donations are relevant to the mobilisation of funds, whereas *Musharaka* is relevant in terms of deserving a share of the surplus, again, in proportion to contributions.

3.7.1 THE IMPLIED WAIVER (*TAKHARUJ* AND *MUBARA'AH*⁵⁸) RELATIONSHIP

One inter-participant relationship traditionally receiving little attention from those writing about *Takaful*, is the *Takharuj* and *Mubara'ah* relationship. This relationship suggests an implied contract where participants waive their rights and obligations. Closely associated with *Takaful* operations, this contract concerns surplus distribution, liquidation of the *Takaful* system and/or reserve distribution. Thus, the *Takaful* operators and supervisory authorities should be clear on the principles of implied waiver regarding claims between departing policyholders prior to the occurrence of any events stated in the policy. Thus, policy documents must clearly outline the principles of *Mubara'ah*.

Also, the *Takaful* surplus, and any remaining reserves related to it, may be treated after liquidation in two ways. Firstly, the policy may state that, at the point of liquidation, the surplus, meaning any remaining reserves and amounts, shall be donated to a charity fund. Indeed, a charity account is the official avenue for any money which is not able to be returned

⁵⁸ *Takharuj* and *Mubarahah* are Arabic terms (linguistically) meaning get out, release or disappear, and in technical terms refer to legal procedures set out for participants in the case of cancellation of an insurance policy either by the company or by the participant.

to the original owner. Thus, it is preferable to state in the insurance policy or by-law that the surplus shall be donated to charity along with any remaining reserves⁵⁹.

This approach creates a *Waqf* fund or charity asset⁶⁰ from surplus. Secondly, it is also permissible to distribute the surplus among existing policyholders on the date of liquidation. However, the problem with the second alternative is that, by the time liquidation has materialised, a large number of participants may have withdrawn from the pool leaving their rights to the surplus and reserves behind. In order to deal with this situation, application of the principle of “waiver of claims and obligations” or *Mubara’ah* becomes necessary. *Mubara’ah* guarantees that sums generated by departing participants become permissible to remaining participants on the date of liquidation. When the *Takaful* surplus is distributed according to contribution size, there may be some remaining money for departing/withdrawing members. As previously mentioned, this money should be distributed among remaining participants according to the proportions of their contributions. In applying the principals of *mubar’ah*, this money belongs to individual members. The operator is not entitled to take such an amount⁶¹ however.

3.7.2 THE RELATIONSHIP BETWEEN PARTICIPANTS AND THE OPERATOR

The element of cooperation in *Takaful* is shared between the participants themselves. Relations between the company and participants are governed by the ethos of business and trade and/or contracts of exchange. In other words, the *Takaful* operator does not operate on the basis of cooperation since participants do not contribute to help the operator and vice versa⁶². Hence, a contract of donation is not relevant as far as the relationship between the participants and the operator is concerned. In short, when one person asserts that Islamic insurance is based on donation rather than profit making, it this does not mean that the

⁵⁹ Manjoo. F. (2007) Risk Management, supra footnote 21. P16

⁶⁰ Mughal, Zubair (2008). *Takaful can help Reduce Poverty*. Economic Review (05318955); Feb/Mar2008, Vol. 39 Issue 2/3, p21-22, 2p available online at: <http://search.ebscohost.com/login.aspx?direct=true&db=buh&AN=33871110&site=ehost-live>

⁶¹ Mohammed Burhan Arbouna. Supra footnote 10, p 23-24.

⁶² El Qora Daghi.A (2006), Islamic Insurance, supra footnote 17 Sharaf al-Din.Ahmed (1983). *The verdicts of Insurance via the Legal and Judiciary system*. Kuwait University Edition.

operator is not aiming to make a profit. The *Takaful* operator manages underwriting and investment activities purely via business and trade. This means that the *Takaful* model is not intended to make profit by merely providing guarantee against risks. However, management aspects are carried out on the basis of exchange, much like any other transactions. In this respect, relationships between the *Takaful* operator and participants take various forms. Form depends on whether the *Takaful* operator is operating on an *agency-agency* basis or an *agency-Mudarabah* basis; explained below.

3.7.2.1 The Agency-Agency (Wakalah) Basis

With this type of business relationship, existing participants authorise the *Takaful* operator to manage insurance operations on their behalf. Under this contract, the *Takaful* company is duly responsible to prudently manage insurance activities according to standard of industry. Omission of this contract will disqualify the *Takaful* operator from accepting contributions from the participants. In addition, absence of this contract will also disqualify the *Takaful* company from processing application forms according to certain standards. This procedure entertains any claim made by participants, and what is more, awards indemnity to any participant who experiences the insured risks⁶³. On the basis of *Wakalah* operation, the *Takaful* operator is entitled to a services fee from the *Takaful* fund.

In addition to managing the insurance files, Islamic cooperative insurance also invests money, received from participants, through special investment structures. In this case, the company is entitled to a specified commission (a fixed sum of money) or a certain percentage of the total contributions. This sum is collected in respect of placement and investment of insurance monies on the basis of *Wakalah* or agency. In this relationship, the operator earns commission, be it a fixed amount or a percentage of the contributions, regardless of the performance of the investment. In this model, the *Mudarabah* concept is irrelevant, as there is no *Mudarabah* relationship between the operator and participants. From the outset, the fund is presented to the *Takaful* operator on an agency basis. In this scenario, both *Takaful* operations and investments are carried out on an agency basis in mind of remuneration. The entire profit, derived from investment transactions, belong to the policyholders. The *Mudarabah*

⁶³ Susan Dingwall (2006) *The United Kingdom: Regulatory approach to Takaful*. Takaful Articles. ICMIF Takaful. Available online at: <http://www.takaful.coop/> retrieved on 14-08-2012.

relationship is relevant only when the operator is passing an amount to another company in order to invest. Here, the relationship between two companies is referred to as *Mudarabah*⁶⁴.

In this model, cooperative risk sharing occurs among participants with a *Takaful* operator whereby a fee is agreed to be paid to the operator for services presented. The operator shall not take part in underwriting results. An example of this model is the *Takaful* IKHLAS Malaysia.

Takaful IKHLAS⁶⁵ typically employs the following contracts to govern business:

- A donation contract where participants agree to donate a pre-determined percentage of their contribution to funds intended to provide assistance to fellow participants.
- An agency (*Al-Wakalah*) contract, where participants authorise *Takaful* IKHLAS to conduct the affairs of the *Risk and Special Fund* on their behalf.

See diagram below:

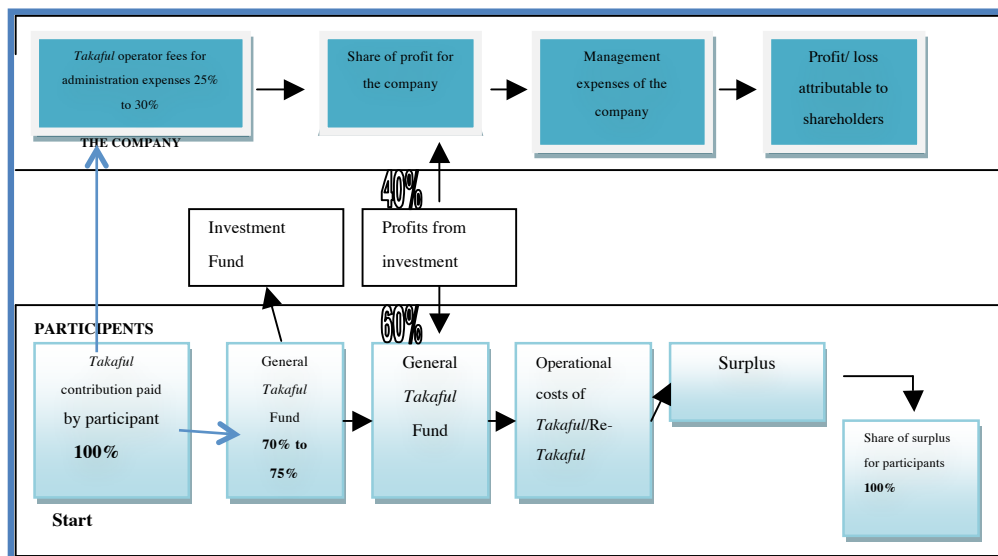


Figure 3.1: Wakalah model (Fee based Agency)

⁶⁴ Prof. Wan Axis. Y. *Takaful* - An Option to Conventional Insurance: A Malaysian Model available online at ; http://site.securities.com/doc_pdf?pc=IG&sv=IFIS&doc_id=102186456. Retrieved on 14-08-2012.

⁶⁵ *Takaful* Ikhlas Malaysia. available online at; <http://www.Takaful-ikhlas.com.my/corporateProfile/TakafulModel.asp> Retrieved on 14-08-2012.

3.7.2.2 The Mudarabah Relationship

This refers to co-operative risk sharing where participants and operators share in the distribution profit. An example of this model is the Syarikat Takaful Malaysia Berhad (STMB). It is held that, by this principle, the entrepreneur or *al-Mudharib* (Takaful operator) will accept payment of Takaful installments or Takaful contributions (premiums). These payments are termed *Ra's-ul-Mal* via the investors or providers of capital or funds (Takaful participants) acting as *Rabui-ul-Mal*. Contracts specify how profits (and surplus) from Takaful operations is managed by the Takaful operator, to be shared amongst policyholders, in accordance with the principle of *Mudarabah*. Thus, profits and surplus are shared among participants as the providers of capital. Here, the Takaful operator assumes the role of the entrepreneur. The sharing of such profit (surplus) may be in a ratio of 5:5, 6:4, 7:3, etc. as mutually agreed between contracting parties⁶⁶. However, the first two licenses issued by Bank Negara were under the *Mudarabah* model yet these Banks have now switched to the combined model, applied to all new business in Malaysia⁶⁷.

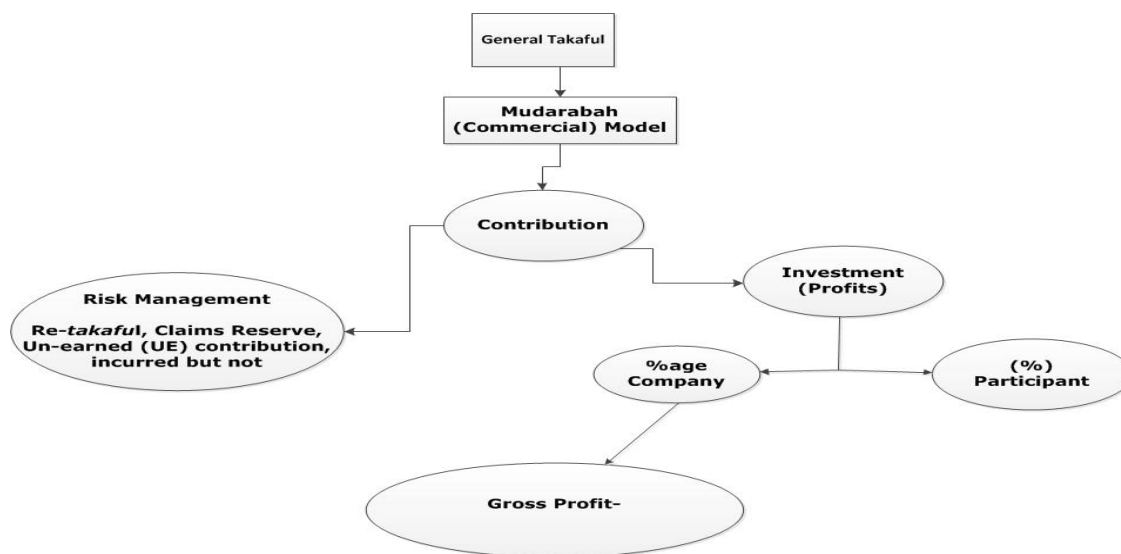


Figure 3.2: Mudarabah Model

⁶⁶Syarikat Takaful Malaysia Berhad (STMB) available online at; http://www.Takaful-malaysia.com/V5/index.php?option=com_content&task=view&id=23&Itemid=36

⁶⁷ The World Takaful Report (2010). *Managing Performance and Recovery*. April 2010. ERNST & YOUNG.

3.7.2.3 The Mixed Agency-Mudarabah Relationship

In brief, *Mudarabah* is an investment instrument in which members recruits experienced and skilled persons to invest the fund. In other words, it suggests that one party owns money without the financial skill and/or time to invest. Whereas another party may involve an experienced and skilled person without money. Hence, the fund's owner will present funds to the skilled entrepreneur so as to create a *Mudarabah* mechanism of investment and profit share, if appropriate⁶⁸. With this form of investment, there are a number of issues to consider, including the various capacities of the skilled entrepreneur (*mudarib*) and what he or she is entitled to do. Our concern here is how this instrument penetrates the Islamic insurance industry and becomes a model of operation in many parts of the Muslim world.

It must be noted that there is no doubt that the *Mudarabah* is not the basis for the mobilisation via *Takaful* contribution. Furthermore, the *Mudarabah* is not applicable to operations concerning indemnity, document preparation and other related administrative issues. Nevertheless, *Mudarabah* appears to encompass elements of agency, with regard to buying and selling and litigation, on behalf of the capital provider. If this is indeed the case, the application of *Mudarabah* in the *Takaful* industry requires further investigation.

The *Mudarabah* concept has become relevant to *Takaful* as an industry because, in the past, operators had perceived participants as one entity. By the same token, members have given their entire donation fund to *Takaful* operators for indemnity purposes, on one hand, and for investment purposes, on the other. As such, the rules of *Mudarabah* appropriately govern the investment relationship between participants, as capital providers, and *Takaful* operators, as entrepreneurs⁶⁹.

However, operators acting on a *Mudarabah* basis often find it difficult to separate these important aspects of *Takaful*, constituting the co-operation of parties regarding payment. This also means that throughout *Takaful* processes, there is counterpart risk associated with *Mudarabah* contracts, concerning compensation for an insured risk, known as the "Fund

⁶⁸ Islamic Sharia Standards. Sharia Standards on *Mudarabah* Contract, Published by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). , Bahrain, Page 236. 2004.

⁶⁹ Mohd. Daud Bakar "Distribution and Compensation Issues of *Takaful* Products", Paper presented at the International Conference on *Takaful*/Islamic Insurance 2-3 June 1999, Hilton Kuala Lumpur, p. 6.

Mobilisation Relationship (FMR)”. In the beginning, the initial aim of participants is not *Mudarabah*, as such. *Mudarabah* is a secondary objective, since it would be unprofessional to maintain a mobilised fund without investment. Therefore, “*Mudarabah* model” operators find it necessary to reflect the principles of solidarity and indemnity. With this in mind, the operator would divide received contributions into two sets, namely Participants’ Special Accounts (PSA) and Participants Accounts (PA). The participants’ special account PSA is basically employed as the *Takaful* operation account whereas PA’s are administered on a *Mudarabah* basis. See diagram below.

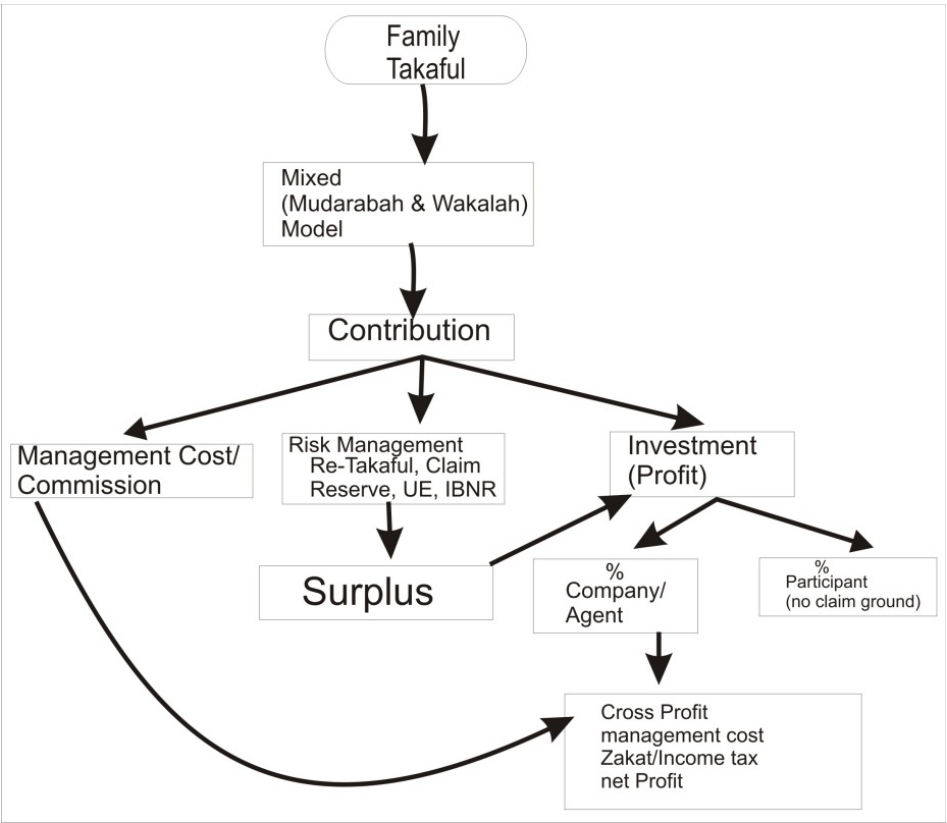


Figure 3.3: Family Takaful Mixed Model

As a result of the above, a scholars current role involves investigating how best to characterise these divisions within donation amounts whilst considering investment on a *Mudarabah* basis.

In fact, the function of *Takaful*, on the basis of the *Mudarabah*, may be characterised as follows⁷⁰:

1. In relation to Participants' Special Accounts (PSA's), i.e. the account from which an indemnity is made, it is suggested that PSA's should be administered on an agency basis. It has also been suggested that this should be done for a fee, since the process involves a number of duties including: management of underwriting activities, printing, processing application forms, actuarial considerations, performing the duty of disclosure under the principle of utmost good faith, investigating and processing claims, paying compensation and other related activities. The maintenance of this agency is the underlying factor assigning the *Takaful* operator the authority to accept contributions in the first place. Without this contract the concept of *Mudarabah* in *Takaful* would fail; it is not the contract that justifies the permissibility of *Takaful* operations.

This agreement implies that, by default, a *Takaful* contract has taken place between participants. In which case, participants are simply authorising the operator who has been granted license to conduct insurance activities and hence is entitled to administer the *Takaful* fund along with other related issues. The *Takaful* operator is then entitled to introduce certain changes or conditions in order to deem the agency contract acceptable. At this stage, the *Takaful* operator is entitled to accept offers and to manage the *Takaful* insurance on condition that the amount to be received will be evenly divided between *Takaful* operations and *Takaful* investments.

On occasion, the *Takaful* operator may realise that the investment agency relationship is not profitable for operations. This is because, in an agency, commission is normally determined in advance, as a lump sum, or according to a percentage based on collected contributions. In cases where external companies are brought in to manage the *Takaful* fund, this commission may not be sufficient to cover operator expenses,. Hence, the operator may shift towards a viable alternative. At this point, it would be unreasonable to demand that the *Takaful* operator

⁷⁰Manjoo. F. (2007) Risk Management; A *Takaful* Perspective. Supra footnote 21. El Qora Daghi.A (2006), Islamic Insurance. Supra, footnote 17.P65. Biltaji. M. *The Insurance Contract from the Perspective of Islamic Jurisprudence*. Supra footnote 15. Ma'sum Billah. M(2007). *Applied Takaful and Modern Insurance Law and Practice*. Supra footnote 9.

stick to the agency relationship when the operator considers a *Mudarabah* relationship to be more profitable for both parties. In a *Mudarabah* relationship, the *Takaful* operator may also manage *Takaful* operations free of charge in exchange for a higher percentage of profits.

2. The Participants' Account (PA), should be based on a *Mudarabah* contract between participants and the operator. In this instance, the *Takaful* company invests the *Mudarabah* portion of contributions via a profit sharing basis within the parameters of the *Mudarabah* contract. This is done in respect of issues relating to the determination of a profit ratio, the marketing in *Mudarabah*, and the party who bears the expenses of *Mudarabah*⁷¹.

In addition to his/her/its profit share, the *Takaful* operator may also earn an agency fee for managing *Takaful* activities. However, questions may arise as to whether the *Takaful* operator may forgo his/her/its profit share as *mudarib*, or his/her/its agency fee as manager, and instead agreed to an entitlement of the surplus, if any exists. This issue requires further investigation. Nevertheless, the primary view would be that the principles of *Sharia* require advance determination of the amount/fee involved in agency, otherwise uncertainty impacts upon the reimbursement contracts. The agency contract, involves an exchange of interest between the operator and participants, as the operator does not act in the spirit of donation.

Hence, leaving the remuneration undefined renders an agency contract null and void⁷². Again, as the potential to accumulate surplus remains unknown, any agency contract, based on the concept of sharing surplus as a fee for agency will be deemed invalid.

This apart, questions may arise regarding *Sharia* Law and the classification of the mobilised funds including the *Takaful* fund and the *Mudarabah* fund. In answer to this, upon the signing of contracts between participants and operators, there is an implied assumption that participants have qualified their donations. In other words, the *Mudarabah* model suggests that participants only consent to part with their contributions in order to make donations and invest on the basis of *Mudarabah*. This action falls under the issue of qualified donation, discussed

⁷¹ Arbouna, Mohammed Burhan, "The Operation of Re-takaful (Islamic Reinsurance) Protection", Arab Law Quarterly, [2000], pp. 335-362. Available online at: <http://www.jstor.org/stable/3382184> . Retrieved on 14-08-2012.

⁷² Algari.M 2009. *Al fai'id Altaaminy*. Supra footnote 19. P16.

earlier⁷³. The rationale for characterising both *Mudarabah* and *Takaful* models in the manner explained above can be explained in terms of the *Sharia* legal maxim. The *Sharia* states that acts by Muslims, and/or persons of senses (*uqala'a*) must be corrected or deemed acceptable as far as possible, even when acts are based on in-famous or unfavourable juristic views⁷⁴.

From this, one may argue that the practice known as *Mudarabah*, is in fact, the agency-*Mudarabah* model, since there is a element of agency within a *Mudarabah* contract. With this structure, the *Takaful* operator's relationship with participants could be that of *mudarib* and *rabb-ull-mal* on one hand, and *agent* on the other; perhaps *mudarib*, with respect to investment of the contributions. In this case, the operator earns a profit ratio if profits are to be realised by way of monies invested via the *Mudarabah* model, namely between the company and its participants: the investors. Here, the benefits realised by shareholders are not restricted to surplus, as is the case with conventional, commercial insurance. Furthermore, the operator also benefits by being paid commission, in functioning as a management agent, in one role, and sharing the profit of investment, in another. This is permitted since there is no rule against receiving profit and remuneration from one entity when acting in different capacities.

Jurisprudential (*Fiqhi*) Analyses of the Malaysian *Takaful Wakalah* and *Mudarabah* Models

The models of *Takaful* are founded on two types of relationships:

1. The relationship between the company and policyholders

Essentially, this sort of relationship is governed by two important contracts:

- The administration of insurance transactions contract, applied through a rental (*Ijarah*) contract, which is considered a contract of exchange. Therefore, the charge, and the contractual benefits and obligations of this agreement, must all be identified.
- The investment contract to the *Takaful* Fund. This can be classed under either *Mudarabah* or *Wakalah* contracts. However, the ratio or wages of

⁷³ *Ibid.* Also see El Qora Daghi.A (2006), supra footnote 17.

⁷⁴ Al-Sarakhsi. Shams ul- deen, *al-Mabsut*, Dar alma'rifah. Beirut (1989). vol. 6, p. 26; vol. 19, p. 1784; Albahooty. Kashaf Algenaa. Almaktabbah Alislamiyah for publishing edition D.T. (1982). Beirut. vol. 4, p.366

Mudarib and/or an agent, must be identified at the beginning of the contract.

In fact this relationship is in line with Islamic *Sharia* law because *Ijarah*, *Mudarabah* and *Wakalah* contracts are permitted in Islamic law when meeting a considerable number of conditions addressed in Islamic *Fiqh* books.

2. The relationship between Policyholders Themselves

This relationship is simultaneously a partnership and a guarantee, thus both parties can be seen as partners and guarantors. Furthermore, he/she/they are partners regarding:

- The investment in the *Takaful* fund.
- The rights to compensation when he/she/they require it.

The individual is also a guarantor in:

- The compensation paid to policy holders.
- Any deficit in *Takaful* funds making it difficult to fulfill *Takaful* obligations.

According to the relationship detailed above, and through researching many *Takaful* papers and websites, the author has identified the following issues associated with *Fiqhi*:

- A. The contract between policy holders is considered a qualified contract of donation. Although some writers continue to advocate the sincere intentions of donation, others insist on a contract of exchange.
- B. Both parties have an obligation to pay and also benefit from the right to receive, which clearly suggests a contract of reimbursement (*Muawadah*) and yet, this *Muawadah* does not affect the contract of donation, as mentioned above⁷⁵.
- C. The relationship between policy holders complies with the application of a *Mufawadah* contract⁷⁶ which is unlawful in the majority of Islamic *Fiqhi* schools; with the

⁷⁵ See page 23-24.

exception of the *Hanafi* School⁷⁷. This is because the *Mufawadah* model includes an element of *Gharar*, uncertainty. Furthermore, uncertainty is obvious throughout this potential contract as policyholders may pay in and yet, might not receive compensation, akin to conventional insurance application.

To sum up, for experts to agree that the *Takaful* model is compliant with *Wakalah* and *Mudarabah* is merely conjecture, as *Takaful* clearly shows that the element of uncertainty is not removed via compensational returns. In fact, the only insurance model to meet Islamic *Sharia* law is arguably the combination of *Wakalah* with *Waqf*, discussed in the next paragraph.

3.7.2.4 The *Wakalah* with *Waqf* Relationship

Waqf (endowment) is an Arabic verb which literally means to detain (*al-habs*). As for the exact technical definition of *Waqf*, Muslim scholars differ in their classifications depending on their position concerning specific elements and conditions recognised as features of *Waqf*⁷⁸. However, scholars do agreed on the basic concept of *Waqf*, which is the permanent dedication of a portion of one's wealth for the pleasure of Allah. This means that a portion of a person's property is alienated from him/her and "transferred" to Allah. In other words, ownership "passes" from the person making the *Waqf* to Allah. Therefore, property cannot be inherited, gifted or mortgaged, etc. Essential to this scheme, the body of the property remains intact while income is derived there from, and/or the property itself is used for certain philanthropic activities on behalf of Allah. This is regarded as a recurring, continuous or on-going act of charity (*sadaqah jariyah*).

⁷⁶ It is a transaction in Islamic law where each party in the contract deputises the other in all matters of money and management. So it is prohibited by the Hnbali, Maliki and Shafee schools; this is because it includes agency contract on the side of the guarantee contract and both contracts include an element of ignorance (*Jahalah*). Thus, in Islamic law, an individual cannot say "I will guarantee this to you and/or make you an agent in everything", so the subject matter must be concrete via both contracts. This is absent in the contract of *Mufawadah*. See more about this contract in Alsarkhasi (1989). *Almabsut*. Kitab alsharikah. Supra footnote 76.

⁷⁷ Ibin Alhumam. K (H861) Fathu al Gadeer. Kitab-u – Alshirkah . Dar Alkutub Alealmia, Lebanon, edition 1 (2003). Volume 6 page 157.

⁷⁸ Al-Sarakhsi, *al-Mabsut*, v12.p27.supra footnot 76. al- Hattab, *Tahrir al-Kalam fi Masa'il al-Itizam*. Supra footnote 45. V6, p18. Ibn Qudamah Almaqdisy(1223AC)(620H). *Almugnee*,V 6. p206.supra footnote 33.

Hashim illustrates that the concept of the *Takaful Waqf* signifies a plan designed to enable any individual to save regularly with the objective of accumulating a fund which may be left as a donation under the *Waqf* system. Through this plan, the participant (or contributor) will amass a considerable sum of money, through the accumulation of *Takaful* instalments, paid regularly over a certain period of time. This would then be sufficient enough to serve as an endowment for *Waqf*. Under this system, benefits are payable either upon the untimely death of the participant or upon the plan reaching maturity. Payments are remitted by *Takaful* Malaysia to any institution named as the *Waqf* recipient⁷⁹.

However, Jakhura. B⁸⁰ (2008) studied the application of *Takaful* based on *Waqf* in South Africa (SA). He held that *Waqf* is created by the participant as a supposed donation, made up of capital held in perpetuity. The *Waqf* then, is commonly managed by company trustees who can charge an administration fee for presented services. Trustees are governed by rules prescribed by participants in deeds and policies.

Jakhura. B (2008) added that, in *lieu* of these administrative services, *Takaful* SA would be entitled to receive a management fee equivalent to 10% of the gross premiums received by the *Waqf* fund. So, with regard to these practices, administration fees will be collected from gross premiums i.e. (the *Waqf* assets and profits). Hence, this application renders the model incompatible with Islamic *Sharia* law. *Fiqhi* schools confirm that this is because the agent's fee (*nazer-u-alWaqf*), must be collected from surplus, as opposed to the *Waqf* fund, unless a participant knows, in advance, that an administration fee will be collected from the premium. The intention of the donor, in this situation, will be different, triggering a suitable treatment which complies with *Sharia*. This is because the objective behind payments is that they will be split into two parts; one for the *Waqf* and the other, towards administration fees.

Jakhura. B (2008), further added that the rules of *Waqf* regulate the membership of *Waqf*, along with payments, contributions, benefits, surpluses and all other relevant matters. All

⁷⁹ Ashraf. Hashim (2008). *The Collection of Waqf through Insurance Companies: A Critical Analysis of the Malaysian Experience*. International Conference On Co-operative Insurance in the Framework of *Waqf*. 4 – 6 March 2008 / 26 – 28 Safar 1429. International Islamic University Malaysia.

⁸⁰ Jakhura. B (2008). *The Application of Takaful Based on the Waqf Model in South Africa*. Paper published by International Islamic University in Malaysia 2008, available online at; http://www.islamfeqh.com/15_4.pdf .

contributions paid to the *Waqf* (as a separate legal entity) pass into the ownership of the *Waqf* to be regulated by terms stated in the *Waqf* policy⁸¹.

This *Takaful* model employs the following contracts to govern businesses:

- A pure contract of donation for *Waqf* purposes alone, where the participant agrees to donate a pre-determined percentage of their contribution to the *Waqf* fund so as to provide assistance to fellow participants.
- The agency (*Al-Wakhalah*) contract, is where participants (*waqif*) authorise the *Takaful* company (agent) to conduct affairs of Risk, operating Special Funds on his/her behalf. Thus, all Islamic verdicts regarding this contract refer specifically to the agent (*Nazer-u-alWaqf*) the application of which has been described in *Fiqhi* books.

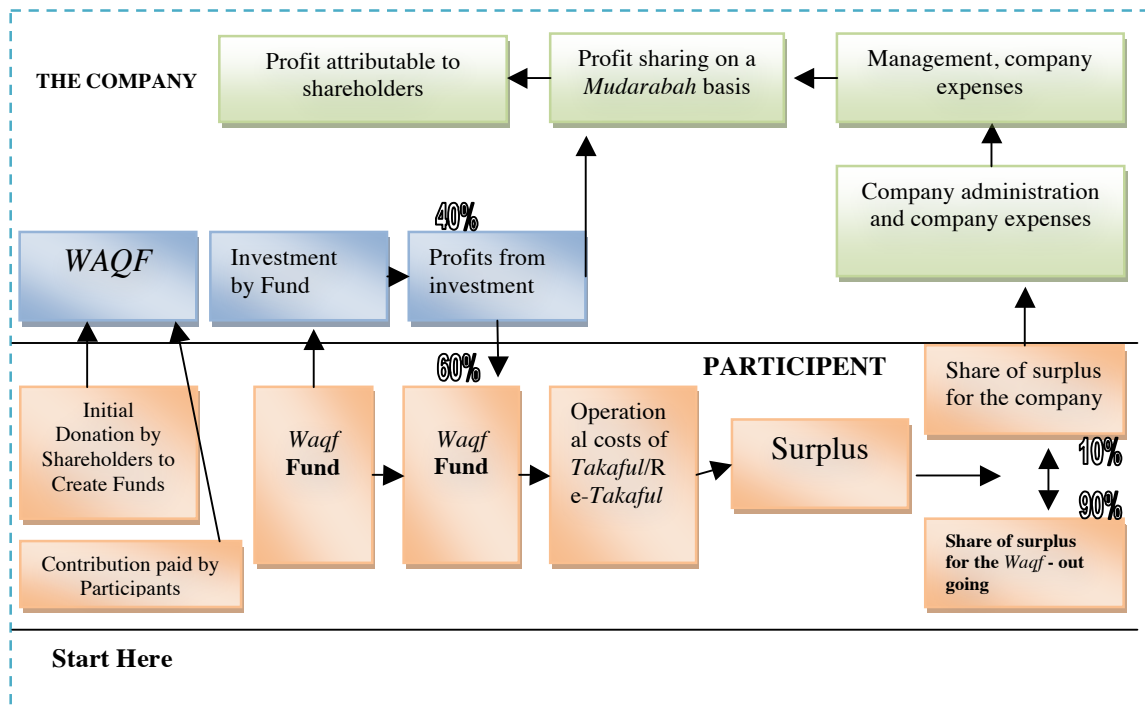


Figure 3.4: Whakalah with Waqf Model

⁸¹*Ibid.*

3.7.2.4.1 The Hybrid Wakalah with Waqf for South Africa

The hybrid model is primarily regulated by the *Wakalah* relationship where the *Takaful* operator acts on behalf of participants. The *Takaful* operator receives contributions from participants and places them in a fund. From that fund, contributions are split into three portions by the *Takaful* operator - as an insurance agent. The first portion goes towards management fees, the second, is contributed / donated to a *Waqf* fund. This is in fact the *Takaful* fund or risk management fund, and so, from this fund *re-takaful* claims and other related costs are paid. The third portion can be placed in an investment scheme. However, the investment fund can equally be managed on the basis of *Shirkah al-anan*⁸² i.e. a partnership whereby the *Takaful* operator can also invest money. This is a separate contract. Alternatively, the investment fund can be dealt with on the basis of *Mudarabah*, where the *Takaful* operator does not invest any capital but simply offers expertise⁸³. This model has been applied in Alnoor *Takaful* in South Africa; as shown in the following diagram.

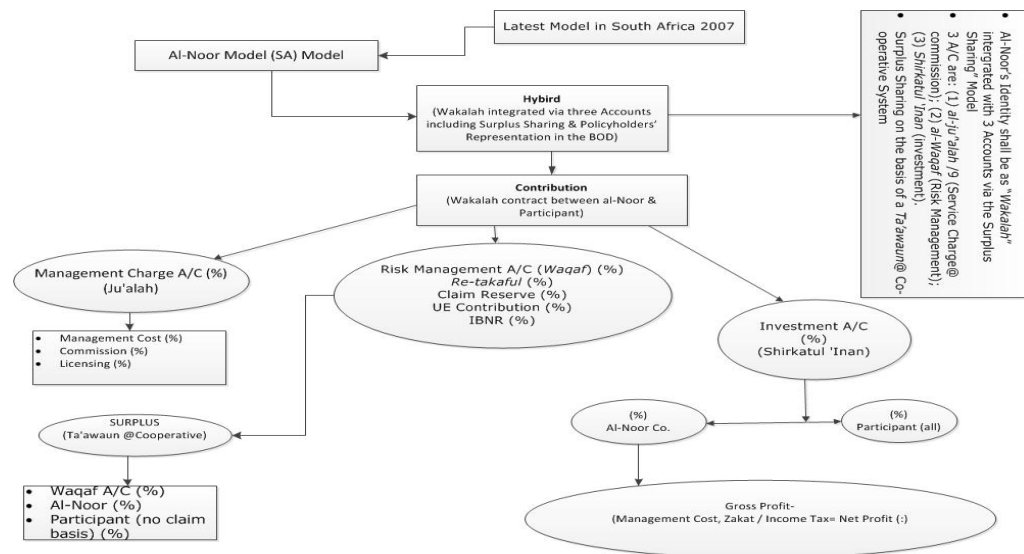


Figure 3.5 Alnoor *Takaful* in South Africa⁸⁴

⁸² Islamic *Fiqhi* is a partnership whereby both partners invest a definite sum of money and benefit from a definite profit share. See more Ibn qudamah Almaqdisy(1223AC)(620H). *Almugnee*, V 6. p206.supra footnote 33. . Ibn Rushd Alhafeed.(595H).*Bidait-ul-almujtahid*. v2. p269.

⁸³ Manjoo. F. (2007) *Risk Management*. Supra footnote 21. Pp.23-25

⁸⁴ Ma'sum Billah. M(2007). *Applied Takaful in Modern Insurance Law and Practice*. Supra footnote 7. p28.

3.7.2.4.2 Advantages of Takaful with Waqf

Aware of the expansion of the *Takaful* industry, many people have found that there are advantages which will benefit them. F. Manjoo⁸⁵ (2007) has cited some of these, as provided below:

1. Profit Motivated

Through conventional insurance the client is treated as a policyholder only, whereas in the *Takaful* industry participants are treated as investors-*cum*-policyholders. Thus, participants in a *Takaful* scheme hit two bottles with one ball. While their risks are covered and indemnified, they also share in the profits generated from the investment fund portfolios.

2. Enhancement of the Spending (*Infaq*) Sector

In Islam, voluntary sectors are highly encouraged and have proven to be efficient in the past via the mechanisms of *Waqf*, *Zakah*, *Zakat-u- al-Fitr* and the Will (*Wasiyah*). The Prophet Mohammed (Peace Be Upon Him) stated: “*Whoever removes a worldly grief from a believer, Allah will take away from him one of the griefs of the Hereafter. Whoever alleviates a hardship (from) a needy person, Allah will alleviate a hardship from him in both this world and the Hereafter...*”⁸⁶

Takaful, represents an expanding avenue, and arguably has the means to reactivate this sector on an

national or even global level. In fact, experts are saying that *Takaful* is the second most important social institution aspiring to counteract poverty and deprivation. A living example of this is the International Co-operative and Mutual Insurance Federation which represents 127 members from 67 countries, all striving to alleviate poverty. Here, Muslims have developed *Takaful* projects to encourage micro financing in countries like Ghana.

⁸⁵ Manjoo, F. (2007) Risk Management, Supra footnote 21.

⁸⁶ Imam An-Nawawi's. *An-Nawawi's Forty Hadiths*. Hadith no 36. Available online at; http://www.40hadith.com/40hadith_en.htm. Retrieved on 14-08-2012.

3. Ethical Contracts

When substituting the insurance contract for a *Mudarabah*, *Wakalah* or *Waqf* model, the elements of *Riba*, *Gharar* and *Maisir* are eliminated (at least to a greater extent if no *re-Takaful* exists, and in this case the regulators do not dictate the channel of funds). Further, investment portfolios are be in line with *Sharia*, thus the return also supports *Halal* (legally allowable by *Sharia*).

4. A savings Pattern is Created

Technically, people participate in different *Takaful* funds are investors in that fund. Whereas, in the case of conventional insurance, the underwriting of many policies means they become non-refundable such in the event of fire and theft. Moreover, if the insured event/contingency does not take place, paid premiums are lost.

The *Takaful* market rate is still low because Muslims have not yet grasped the importance of saving patterns in moulding the financial market. Once this is achieved, *Takaful* may prompt a global upheaval in the financial markets, as Muslims make up 17% of the world population, and therefore, have access to many natural resources.

5. Capital Mobilisation to help the Needy

Muslims mobilise at least 2.5% of their wealth, helping the needy in the form of *Zakah*, with a proper *Takaful* plan. Thus, it seems right that part of the generated profits should go into the voluntary sector. With this system, investment portfolios add more value to people's wealth, thus leading to more *Zakah* being payable.

6. Social Institutions and Support

Currently, Islamic relief foundations lack money whilst in the peak of need. With the *Takaful* system, and particularly the *Waqf* model, these relief foundations can access an institutionally organised income from surplus money generated by *Takaful* companies. An option made possible due to the terms of the deeds, whilst also supporting *Halal*.

3.7.2.5 The Model of Mixed Wakalah – Musharakah Relationship

This is another important relationship within *Takaful* operations; where a company invests its money together with the *Takaful* fund. This combination necessitates partnership in investment. These partners therefore share profits in accordance with the principles of a partnership. In this case, the profit is divided pro-rata. A percentage of profit is intended for the *Takaful* company representing its part of the investment money as a partner. The remaining percentage will be distributed between parties (normally the company and its participants) on a *Mudarabah*, or investment agency, basis.

This process is deemed acceptable by jurists who ask whether it is permissible for a party to act as both *mudarib*, and investor, simultaneously? According to researcher opinion, the answer is yes⁸⁷. In short, the first and third portion the company enjoyed status as *partner* so, in this example, the company has earned its share of the profits. On the same note, two thirds of the company was submerged in the *Mudarabah* or agency relationship with participants, and so deserves its agreed share of profits; see the following diagram.

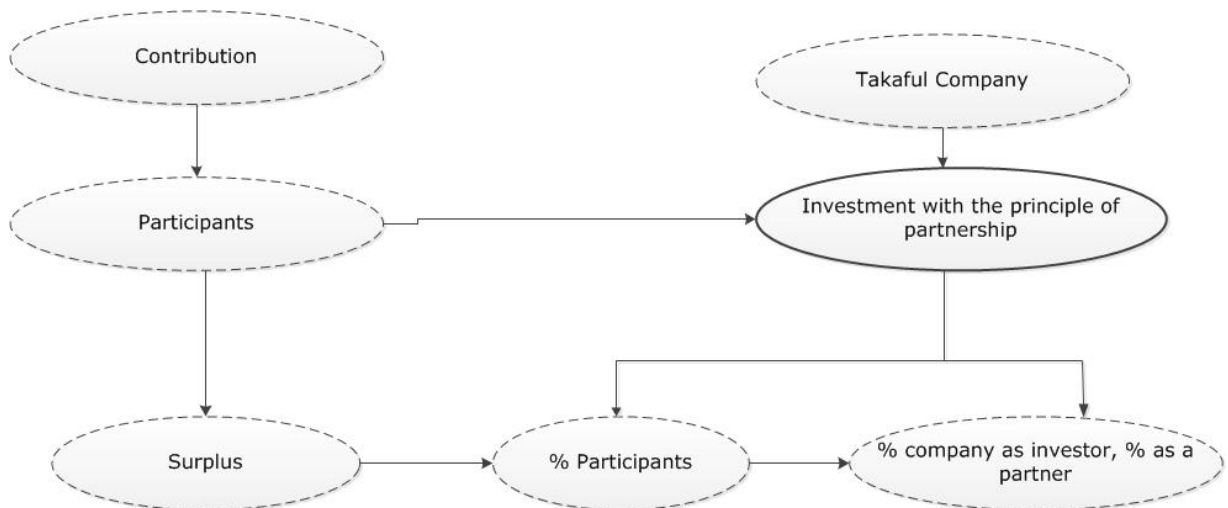


Figure 3.6: Mixed Wakalah – Musharakah Model.

⁸⁷ Ibn Qudamah Almaqdisy(1223AC)(620H). *Almugnee*,V 6. p206. supra footnote 33.

3.7.2.6 Family Takaful Models

As Ali (1989) has stated, with this type of *Takaful* insurance, the policy features a defined period of maturity, where the insured make periodic premiums used primarily to meet individual savings targets. Premiums are also used, in part, to financially assisting the bereaved families of the deceased insured. Premium amounts vary from person to person primarily depending on the sum (face amount) that each insured participant is targeting to accumulate at the end of their period of coverage. Age, gender and health also factor into this equation.

The insurer may set a minimum face amount for this purpose. They may also set minimum and maximum age limits in terms of participating in this type of policy. Additionally, insurers can decide to accept standard risks only and to maintain separate classes of insured people, perhaps of the same age but with different years of entry to the plan⁸⁸ for example.

Takaful life insurance is also used for other purposes, including generating a fund for children's education, securing a fund in case of a mortgagor's premature death and protecting business interests against a key employee's death. Several *Takaful* policies now come with riders regarding hospitalisation and disability benefit. In fact, there is virtually a counterpart *Takaful* life insurance policy for each major type of conventional insurance policy, while differences lie in how premiums are allocated⁸⁹.

However, by using investment as a method, a *Takaful* operator (insurer) can credit installment premiums to two separate accounts - the individual account and the special account, of each insured member - . *Takaful* insurers invest funds in both individual, and special accounts, in the form of mutual funds, consisting primarily of stocks from financial institutions and manufacturers producing goods and services permitted by Islamic *Sharia*; see figures illustrating Family *Takaful*, presented below.

⁸⁸ Ali, Kasi Mohammed. Mortuza, 1989. "Principles and Practices of Insurance under an Islamic Framework," Insurance Journal, (December): 29-38.

⁸⁹ See Malaysia *Takaful* available online at:

<http://www.takaful-malaysia.com.my/family/products/Pages/default.aspx>

If an insured person lives long enough to meet their target savings amount, determined at policy inception, the insured party receives a full refund of all premiums he/she has paid into his/her individual account. He/she will also receive his or her shares of investment income from that account. In addition, his or her shares of surplus will be assessed from the special account.

Takaful insurers also permit their insureds to surrender policies prematurely. When an insured exercises this option, he or she will receive a refund of all premiums plus his or her share of surplus from their individual account (minus administrative expenses) until the date of surrender. However, no refund is usually given from the special account when a policy is surrendered. In a typical *Takaful* insurance plan, little consequence is awarded to whether or not an insured member surrenders in a manner prescribed by his or her policy since all participants are, in principle, partners of the same insurance plan.

The process of family *Takaful* models:

1. Mudharabah Model

In this model the operator deals with investment on the basis of a shared percentage.

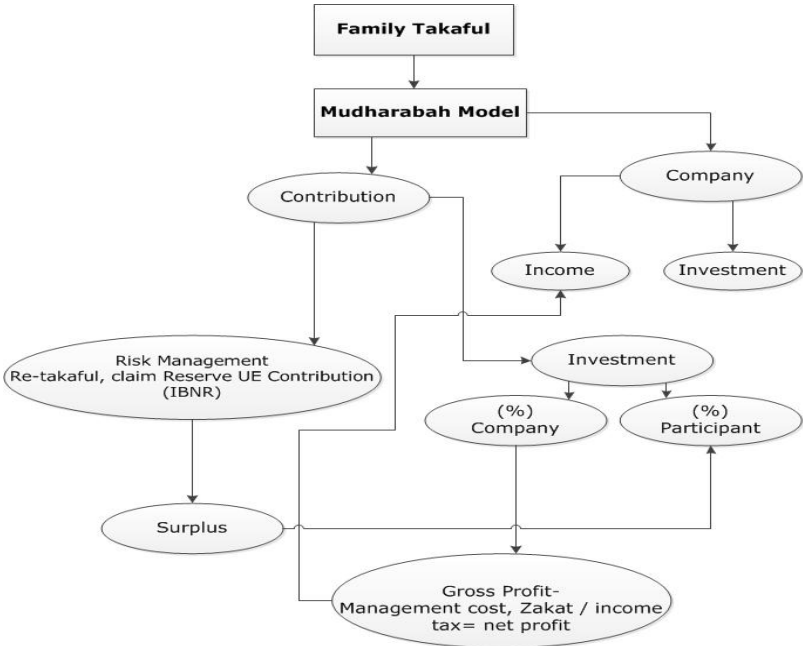


Figure 3.7: Family Takaful Mudharabah Model

2. *Wakalah Model*

In this model, the agent deals with investment on the basis of a pre-determined fee rather than a percentage, as in the *Mudarabah* model (detailed above). If this occurred then the contract would be void because of the existence of ignorance/uncertainty regarding fees.

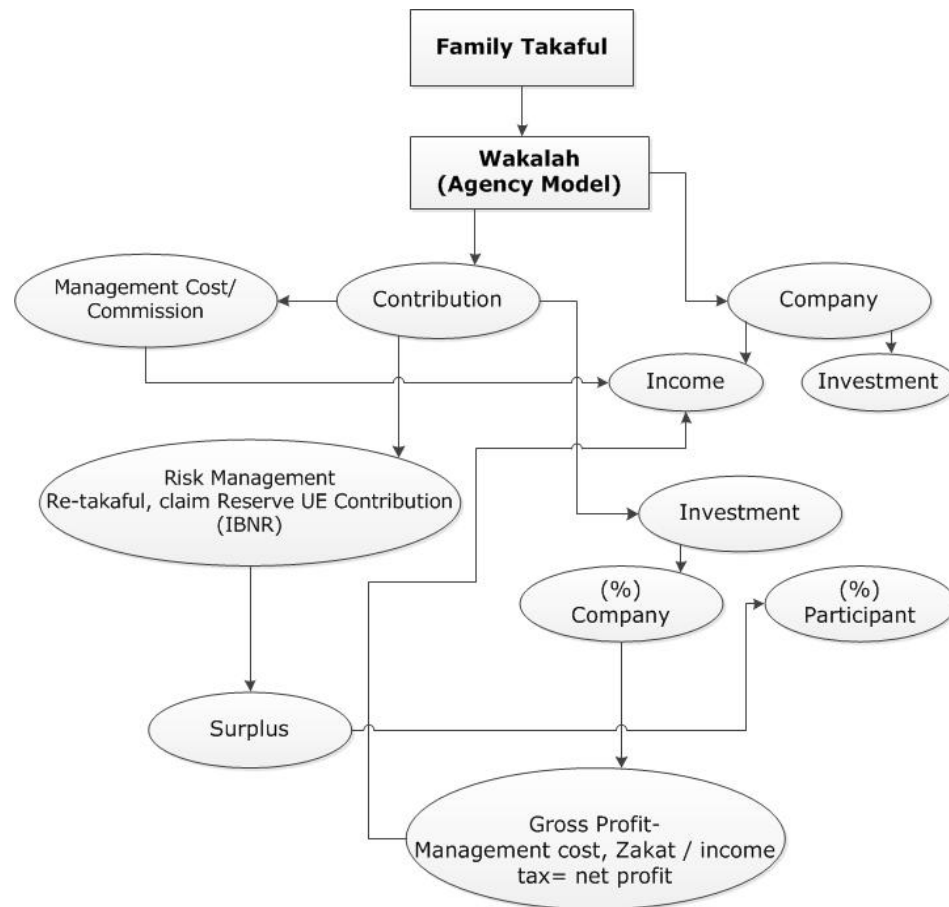


Figure 3.8 Family Takaful Wakalah Model

3. *Mixed Mudarabah and Wakalah Model*

In this model the operator receives benefit from a pre-determined fee for management costs under the *Wakalah* contract and a shared percentage from investment profits under the *Mudarabah* contract.

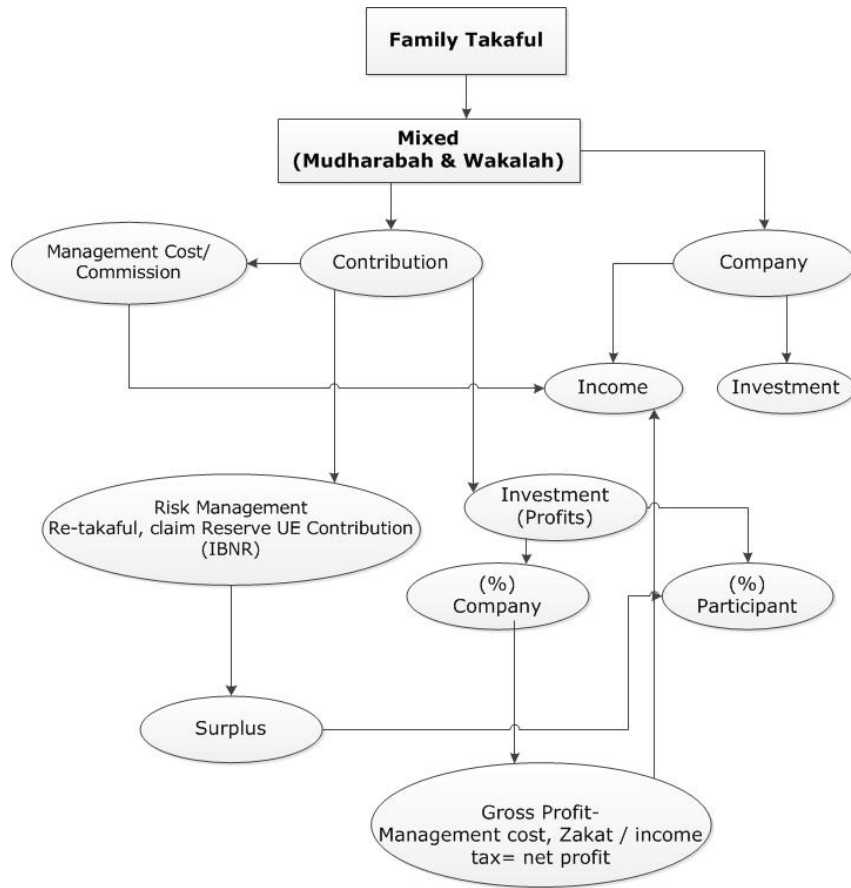


Figure 3.9 Family Takaful Mixed Model

3.8 Issues and Ruling of Surplus

In modern writings based on *Takaful*, it is very common to come across the terms profit and surplus. Throughout the *Takaful* industry, widespread use of these terms can sometimes be confusing. For example, one observes that the term profit is given to surplus and vice versa. This perhaps calls for an explanation, as far as use within the *Takaful* industry is concerned.

3.8.1 SURPLUS, CONTRARY TO PROFIT

By definition, “insurance, or underwriting surplus, denotes an excess of the total premium contributions paid by policyholders. An event that occurs during the current financial period and includes the total amount of indemnities paid in respect of claims incurred during that period, along with net re-insurance and deductions for expenses and changes to technical provisions”⁹⁰. This definition indicates that any surplus left after the payment of indemnities and expenses, and the transfer of reserves, is distributed amongst policyholders. This is simply because these amounts form part of their contributions. In this context, surplus cannot be described as profit. Profit refers to returns gained upon recovery of invested capital, or to a monetary value over and above the capital after investment. According to the juristic terminology, profit constitutes capital, or the income and revenue accumulated over and above capital. In short, profit means adding additional financial value to capital⁹¹. Thus, in underwriting activities, there is no profit but rather surplus.

3.8.2 SHARIA RULINGS PERTAINING TO SURPLUS

As the term indicates, surplus is the remainder of a contribution after the payment of indemnities and expenses and after the transfer of reserves. Thus, surplus should be distributed among policyholders, simply because these amounts form part of their contributions⁹². The *Sharia* ruling on surplus is derived from the origin of that surplus, i.e. via premium

⁹⁰ AAOIFI, Accounting, Auditing and Governance Standards for Islamic Financial Institutions 2002, p. 400.

⁹¹ Ibn Qudamah Almaqdisy(1223AC)(620H). *Almugnee*, vol. 5, p. 33.supra footnote 33

⁹² Algari.M 2009. *Al fai'id Altaaminy*. Supra footnote 19.

contributions. In this case, surplus is the sole right of participants, unless participants contractually agree that the operator is to share in this surplus⁹³ as discussed below.

3.8.3 METHODS OF *TAKAFUL* SURPLUS DISTRIBUTION

There are a number of methods, used by Islamic insurance companies, to distribute surplus. These methods are approved via standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). This is because, these methods do not violate the principles of *Sharia*, but rather they compliment actions that form part of insurance by-laws.

Among these methods are the following:

1. The allocation of surplus to all policyholders, occurs regardless of whether or not they have made claims on the policy during an agreed financial period.
2. Allocation of surplus among policyholders only, specifically those who have not made any claims during the current financial period.
3. Allocation of surplus among those who have not made claims as well as those who have made claims of amounts less than their insurance contributions. This is provided that the latter category of policyholders receive only the difference between their insurance contributions and their claims, during the present financial period⁹⁴.

3.8.4 APPLICATION OF SURPLUS AND RESERVES FOR INNOVATION

Whether or not the operator shares the surplus with participants, another product could be invented using the reserves and surplus. For example, the *Takaful* operator may design a product that would allow him/her/it to guarantee participants a secure credit facility against their entitlement to surplus. For example, the surplus may be held without distribution, in aim that participants may secure credit facilities from Islamic banks, against the surplus amount⁹⁵.

⁹³ *Ibid.* p6. Also see Haytham Haidar. (2009) *Al fai'id Altaaminy*. Supra footnote 20.

⁹⁴ AAOIFI, Accounting, Auditing and Governance Standards for Islamic Financial Institutions 2002.

⁹⁵ Mohammed Burhan Arbouna. *Regulation of Takaful Business: A Shari'a Overview of Contractual Aspects of Takaful Models*. Supra footnote 10. p30

This suggestion is perhaps possible as the *Takaful* operator is not party to the *Takaful* system. In other words, its personality is separate from the participants' legal personality. Therefore, in this context, the *Takaful* operator may guarantee any participants secure credit from other sources. Furthermore, the *Takaful* operator will recover the debt should there be any default by any of the participants in regards to the surplus or any money remaining in the insurance policy. However, the acceptability of this suggestion and the mechanism of its implementation are subject to thorough research under the general principles of *Sharia* and of *Takaful* practices.

3.8.5 SHARING SURPLUS AS AN INCENTIVE TO GOOD PERFORMANCE

The sharing of surpluses by participants, operators and shareholders is a critical issue within the Islamic insurance industry. In explanation, surplus is the absolute right of participants because it is *fadl* or *fai'id* (remaining) of participants' contributions that have not been put into use. On the other hand, it is noted that some *Takaful* operators consider surplus as profit to be shared with participants. This raises questions of legality and leads us to ask whether it is an absolute principle that, regardless of model, surplus can never be shared between participants and operators. This is not an absolute rule, because the sharing of surplus by the operator may be characterised under some *Sharia* principles. Perhaps this is why some *Sharia* Boards permit shareholders to share in the underwriting of surplus with policyholders⁹⁶. If this *fatwa* exists, then the *fatwa* may be interpreted as stating that the operator is entitled to share in the surplus with participants, on basis of the following conditions:

- 1) The operator manages insurance activities and investments founded on agency, without consideration, and is entitled to share in the surplus as an incentive or reward for good performance⁹⁷.
- 2) The operator manages the insurance operations on the basis of agency without consideration and manages participants' fund on the basis of *Mudarabah*. In this case, the operator is entitled to share in the surplus as an incentive or gift for good

⁹⁶The author did not witness *fatwa* although this is recorded in *Fatawa Hai'ah al-Raqabah al-Shari'yya of Bank Faisal Faisal al-Islami al-Sudani*, vol. 1, p. 22 .

⁹⁷ Algari.M 2009. *Al fai'id Altaaminy*. Supra footnote 19.

performance. The operator is entitled to share the surplus as an incentive or reward for good performance providing the following conditions are observed⁹⁸:

1. Policy certificates signed by customers, must clearly state that insurance operations are carried out on the basis of agency and are free of charge.
2. The policy must state that the operator is entitled to an incentive gift for good performance if there is surplus.
3. The term of profit must be avoided where the operator shares the surplus with participants because profit is a result of investment and surplus is not related to investment. Put differently, surplus is not money that was generated due to investment. The use of the term “*Mudarabah* profit” in relation to surplus, suggests that surplus, is a result of an investment and this assumption is not correct, neither in theory nor in practice.

⁹⁸ See report prepared by the committee appointed by AAOIFI to discuss various aspects of Islamic Insurance Activities.

3.9 The Reinsurance Arrangement and Investment

According to the practice of Islamic insurance, the relationship of re-insurance companies and *Takaful* operators is set out as follows:

- a. The Re-insurance Company will mobilise premiums/policies from insurance companies.
- b. The Re-insurance Company assumes responsibility to invest this fund on a *Mudarabah* basis alongside other *Takaful* operators.
- c. The proceeds will be evenly distributed between the Reinsurance Company and *Takaful* operators on the basis of a defined percentage in respect of participating certificates given to participating companies. This percentage, say 10% of the proceeds, belong to shareholders of the Re-insurance Company. The remaining, 90%, is to be added to the *retakaful* fund.
- d. In the event of danger, reinsurance will indemnify the defined risks and settle the expenses via *Takaful* taken from the overall premiums, reserves and proceeds of investment.
- e. In the event of surplus, this must be returned to the *Takaful* fund in accordance with the contribution of each and every *Takaful* operator.
- f. In the event that the Reinsurance Company cannot indemnify the defined risks, it may borrow from the *retakaful* fund under the terms of a loan.
- g. It is evident from this process that the Reinsurance Company does not have any financial interest other than its share in the proceeds of *Mudarabah*, if any⁹⁹.

See following diagram:

⁹⁹ For more details on reinsurance from an Islamic perspective, see Arbouna, “*The Operation of Retakaful (Islamic Reinsurance) Protection*”, supra footnote 73. pp. 335-362.

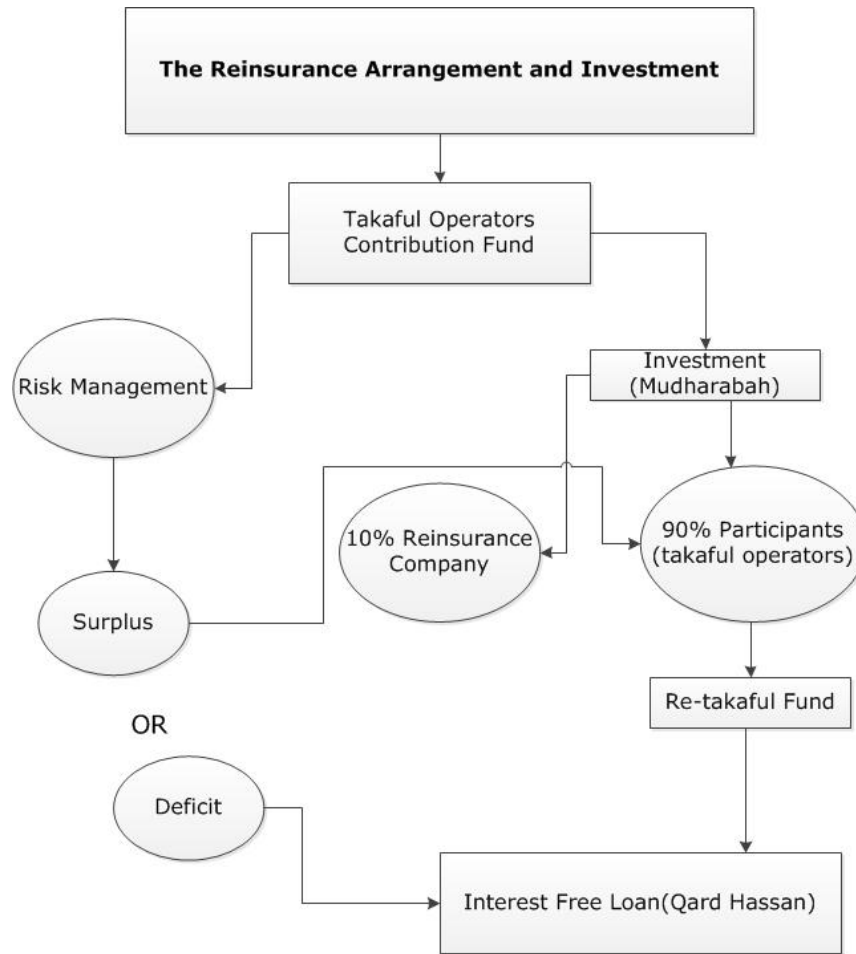


Figure 3.10 The Reinsurance Agreement and Investment

3.10 Arranging a Loan Facility to cover an Insurance Deficit

Earlier on, it was noted that *Takaful* contributions are paid on the basis of a special form of qualified donation. The role of the operator is the management of the insurance pool and the investment of the insurance fund. The operator is not obliged to indemnify from its funds. The indemnities are paid from the insurance pool, created following the mobilisation of contributions from participants.

This is because *Takaful* is not divided between two separate parties; rather, participants represent the insured and insurer simultaneously as they act to insured each other. Therefore, if the *Takaful* fund falls short of meeting the indemnity, the operator may manage this situation in line with AAOIFI Accounting and Auditing Standards on disclosure of bases for

determining and allocating surplus or deficit in an Islamic insurance company. These standards advocate that this situation may be fixed by taking following actions:

- a. To settle the deficit from the reserves of the policyholders, if any.
- b. To borrow from shareholders' funds, and/or from other sources, the sum of the deficit, to be paid back in order to encourage the accumulation of future surpluses.
- c. To ask the policyholders to meet the deficit pro-rata.
- d. To increase future premium contributions on a pro-rata basis.

Generally, if point (a) or (c) are followed then few problems will occur for participants and operators. Nevertheless, point (d) appears to be out of the question. Arguably, this action will not solve immediate difficulties, since money must come from somewhere in order to recover the deficit. Clearly, over the long term, participants will pay via increased contributions. In the author's view, solution (d) is not practical, except in extending debt for the policyholders. Point (b) is also problematic. The problem with this arrangement (b), is that it offers no incentive to encourage the operator or third party, to tender a loan facility. This is because, within the financial world, institutions tend not to offer benevolent loans. Therefore, it would be very difficult for the *Takaful* operator to secure a loan facility from a third party without incentive. The same can be said of shareholders. It follows that shareholders would need to see the benefit of providing a loan to the fund without interest. Thus, it seems a form of incentive must be devised to encourage a loan provision facility. This incentive lies in the concept of the "mutual exchange of loans" or *tabadul al-qurud*, approved by AAOIFI *Sharia*¹⁰⁰ along with a number of *Sharia* Boards of Islamic banks and insurance companies¹⁰¹, in order to avoid interest payments, and at the same time, secures a loan.

The *Sharia* Board of Jordan Islamic Insurance argued that, "there is no objection for the operator and the participants to exchange loans when one of the parties is in need of a loan without interest"¹⁰². According to the al-Barakah Forum on Islamic economics "it is

¹⁰⁰ AAOIFI, Shari'a Standard No. 1: Trading in Currencies clause 2/4 (a).

¹⁰¹ See for example The Shari'a Board of Kuwait Finance House, *al-Fatawa al-Shar'iyyah fi al-Masa'il al-Iqtisadiyyah*, vol. 4, *fatwa* numbers 697 and 698 p. 146. Available online at http://www.kfh.com/KFH_Fatawa/Fatawa_Index.aspx. Retrieved on 14-08-2012.

¹⁰² Unpublished *Fatwa* of *Sharia* Board of Jordan Islamic Insurance Company.

permissible not to pay, or receive, interest where two banks agree to exchange deposits of the same/or different currencies in the form of a loan, when each party is in need. This permissibility is circumscribed under the condition that the obligation of one party, to provide the loan is not dependent on the obligation of the other. However, the *fatwa* of some *Sharia* Boards see no legal problem with the conditional exchange of deposits and loans”¹⁰³. Thus, the exchange of deposits and/or loans, *tabadul al-qurud*, is an innovative product that could be introduced into the realm of Islamic insurance to encourage the securing of loans in a fast and effective manner. Further, there are no practical issues when a loan is taken from the *Takaful* operator and awarded to the *Takaful* fund. Nevertheless, the question remaining unanswered is which party approves the loan if the loan is to be released to the *Takaful* operator by participants¹⁰⁴.

3.11 Some Regulatory and Supervisory Considerations

3.11.1 MECHANISM OF MONITORING SEGREGATED FUNDS

It is accepted that the relationship of *Takaful* insurers and their participants necessitates the segregation of funds. From a *Sharia* perspective, this is to ensure that expenses and other risks related to each fund are allocated accordingly. Therefore, regulators need to develop a mechanism to monitor the movement of different funds involved in *Takaful* practices. The importance of this is obvious. Such a system will help regulators to monitor investment risks and expenses and to witness how *Takaful* companies allocate these, as far as shareholders’ and policyholders’ rights and obligations are concerned. The expense and risk relating to the shareholders’ fund should remain with the *Takaful* operator. Whereas, the allocation of investment risks and expenses will depend on the model used by the *Takaful* company¹⁰⁵.

¹⁰³ *Fatawa Hai’ah al-Raqabah al-Shari’iyah Bank Faisal al-Islami al-Sudani*, vol. 1, p. 52-53.

¹⁰⁴ Jummah Mohammed. A (2010). *Maosooaa Fatawa almoamalat almaliyah lil almasarif wlamoassasat almaliyah*. Dar alssalam. Cairo Volume 13. P50- 110, also see Bisher Lotfy. (2009). *Altadawel alaliktroony lil alomlat*. Dar alnafaais. Amman. P54-60.

¹⁰⁵ Mohammed Burhan Arbouna. *Regulation of Takaful Business: A Shari’a Overview of Contractual Aspects of Takaful Models*. p35.

3.11.2 RISK OF MISLEADING THE PUBLIC BY *TAKAFUL* OPERATORS

It is submitted that Islamic insurance connotes agency and operation on behalf of participants. This means that it is participants who establish the *Takaful* fund, and not the *Takaful* operator. As a legal entity, the operator is there to promote business relationships between participants and to encourage more individuals to participate. We call this “selling the *Takaful* fund”, which is an important aspect of the operation. In this scenario, the operator may intentionally, or unwittingly, mislead the public in terms of packages or *Sharia* compliance¹⁰⁶. Therefore, there is a strong argument that there is a need for regulators to monitor this situation¹⁰⁷. It seems, the best way to do this is to appoint an in-house *Sharia* Advisors. The aim of this is to monitor products and daily transactions. A *Sharia* Supervisory Board (SSB) would also complement the requirements of the AAOIFI standards on *Takaful*. Nevertheless, as an SSB, if it existed, would not always be available to direct, review and supervise the daily activities of a *Takaful* company, then there is also a need for regulators to look into the issue of in-house *Sharia* advisors¹⁰⁸.

3.11.3 CAPITAL ADEQUACY REQUIREMENTS FOR *TAKAFUL* COMPANIES

A central issue is whether or not, the capital adequacy requirement of *Takaful* companies enable loan provision or the means to indemnify. The answer to this is very important in view of the fact that *Takaful* companies are considered as agents acting on behalf of their members. As Arbouna confirms, in *Takaful*, the people who indemnify are the participants themselves. This role cannot be adopted by the company, otherwise the *Takaful* would become a contract of reimbursement¹⁰⁹. In other words, the indemnity in *Takaful* may take place, in whole, in part or not at all, when there is no fund to cover the insured risk. This is the cornerstone principle for the permissibility of a *Takaful* operation. The indemnity in *Takaful* is firmly

¹⁰⁶ As an example, investment limits laid down by Saudi insurance regulators permits a maximum of 45% in Stocks and Bonds and 30% in equities. Some of these products are prohibited in *Sharia* and have been applied by many cooperative insurance companies for example, Tawuniya NCCI. See Ajmal Bhatti (2007) *Investment Strategy and Solvency for Takaful companies*. Tokio Marine Middle East. P6.

¹⁰⁷ There is a serious appeal from many scholars in Saudi Arabia identifying critical need to appoint this observational body.

¹⁰⁸ Mohammed Burhan Arbouna. *Regulation of Takaful Business: A Shari'a Overview of Contractual Aspects of Takaful Models*. Supra footnote 10.p 23-24.

¹⁰⁹ *Ibid*, p25.

placed within the realms of possibility and not in the sphere of uncertainty, as with conventional insurance. So the answer, as explained earlier, is the latter.

3.11.4 RISKS OF TAKAFUL MODELS

The *Takaful* models, explained earlier, encompass particular risks. As far as *Mudarabah* is concerned, there is a counterpart risk for each benefit. These risks generally come under the banner of negligence and misconduct. For example, as already discussed, the provision of a guarantee of the investment in *Takaful*, is not allowed, and thus only occurs in cases of negligence and misconduct¹¹⁰. There are also risks linked to the allocation of expenses and investment risks, as discussed earlier. All these may be termed as a “conflict of interests”. In *Wakalah*, the *Takaful* operator may either knowingly or unwittingly consider underwriting and investment policies that would maximise its fees without giving attention to whether such policies protect the right of the participants, especially the need of the participants to see a surplus to be distributed amongst them. On the other hand, since the agent/ *wakeel* will receive fees irrespective of what happens to the *Takaful* fund, the agent may not manage the *Takaful* prudently or in a professional manner required from any risk manager. In order to limit these risks, regulators may make it mandatory for the *Takaful* operator to provide interest free loans to the fund, should there be any difficulties. This should also prevent the *Takaful* operator from requiring participants to pay additional funds¹¹¹.

3.11.5 APPLICATION OF CONVENTIONAL METHODS OF REGULATION AND SUPERVISION

In monitoring *Takaful* companies, regulators may, generally speaking, seek assistance from the administrative principles of conventional insurance companies. Here, regulators may use conventional principles and actuarial rules and apply them to *Takaful* companies. This is an administrative procedure that would not be objected to by *Sharia*. Administrative procedures consist of actions that do not involve any contractual undertakings which may go against the principles of *Takaful* operations. *Sharia* allows us to benefit from the positive features of conventional insurance, management and regulation via the principles of valid public interest (*masalaha mu'tabara*). Further to this, the principles of *al-siyasah al-shari'yyah*, are

¹¹⁰ Ibn qudamah Almaqdisy(1223AC)(620H). *Almugnee*, supra footnote 33.

¹¹¹ Mohammed Burhan Arbouna. *Regulation of Takaful Business: A Shari'a Overview of Contractual Aspects of Takaful Models*. supra footnote 10, p 23-24, also Manjoo. F. (2007) Risk Management. Supra footnote 21.

employed to facilitate rules and regulations that would otherwise have no explicit position within the *Qur'an* and *Sunnah*, provided their use will not violate the basic principles of Islamic law¹¹².

3.12 Conclusion

In recent times, *Takaful* has been recognised by some modern Islamic experts as an alternative product to conventional insurance. This is because the *Takaful* model is free from unlawful elements like gambling, *Riba* (usury) and uncertainty. However, there are significant discussions among modern experts concerning *Takaful*. These discussions generally debate to what extent this system can be considered purely as a contract of donation, a co-operative mutual contract or a contract of reimbursement, in relation to conventional insurance. Further analysis of the models and their approaches, revealed that the model of *Mudarabah* and the model of *Wakalah* are contracts of reimbursement (*Muawadah*). There is actually no difference between conventional insurance and mutual insurance because both clearly include the element of reimbursement (*Muawadah*). Hence, policyholders apply to a company to obtain compensation from a fund. However, an element of doubt remains concerning the receipt of compensation. The only real reason the policy holder applies to this fund is because the fund is restricted among policyholders only.

The only model the author found which complies with Islamic *Sharia* law is *Wakalah* with *Waqf*.

The South African *Takaful* introduces a 10% administration fee – to be collected from the gross premiums (this means *Waqf* assets and its profits). This application makes the model incompatible with Islamic *Sharia* law because the fee of the agent (*nazer-u-alWaqf*, as confirmed in all *Fiqhi* schools) must be collected from the surplus and not from the *Waqf* Fund. Unless the participant knows in advanced that an administration fee will be collected from the premium, so then the intention of the donor in this situation will be different and will comply with *Sharia*, because the payments' intention will be split into two parts; one for the

¹¹² Imam Shawkany(1760). *Irshad alfuhood Fee Ealm Alosool*. Dar Alsalam (1998). Vol 2. P264available online at: http://www.islamweb.net/newlibrary/display_book.php?ID=1&idfrom=1&idto=310&bk_no=100 retrieved on 14-08-2012.

Waqf and the other for an administration fee.

Nowadays, *Takaful* has become a system rather than a financial product. This lends itself to greater preference over conventional insurance. Policy holders can collect profit and create a savings pattern through investments. Further, *Takaful* can be considered a new income channel on the grounds of support through social institutions and thereby enhances the spending (*Infaq*) sector.

Finally, following the critical analysis of *Takaful* as an applied form (described above), the next chapter will outline the legal form of *Takaful* and its application in Saudi Arabia, as the main subject matter in this study.

CHAPTER 4: CRITICAL ANALYSIS OF THE SAUDI INSURANCE SYSTEM FROM THE PERSPECTIVE OF ISLAMIC SHARIA LAW

4.1 Introduction

While establishing the legislative structure of insurance, the Saudi legislator has issued a number of systems and decisions dictating and organising insurance. In 1999 the Regulations of the Council of Cooperative Health Insurance were issued in accordance with Royal Decree No. (R/10) dated on 13/08/1999 for the sake of organising cooperative health insurance. In June 2002, the Council of Cooperative Health Insurance issued the Implementing Regulations for the Compulsory Cooperative Health Insurance System. This insurance has been imposed on all companies employing more than 500 workers comprised of expatriates providing them with proper health coverage. The second phase has included all companies which employ between 100-500 workers from amongst the expatriate population. The third and final phase has included all companies which employ expatriates. The application of this system was announced in the year 2005. However, the Kingdom of Saudi Arabia is determined to be the first country in the world to apply the Compulsory Cooperative Health Insurance System for both citizens and residents; and to raise awareness regarding this matter through mass media as well as other channels.⁽¹⁾

With regards to insurance on vehicles, there was a decision regarding Compulsory Driving License Insurance that was applied as per the Cabinet (The Council of Ministers) Resolution No. 222 dated October 30, 2001. Subsequently the Cabinet issued a decision of Compulsory Liability towards Third Parties for vehicles instead of license insurance. In 2003, the Cooperative Insurance Companies Control Law was issued by virtue of Royal Decree No. (R/32) as of 2/6/1424. The Implementing Regulations of this system were issued following Ministerial Decree No. 1/596 dated on 01/03/1425 H, which allowed the establishment of companies with local business or licensed branches of foreign companies so as to practice cooperative insurance in the Kingdom.

¹A report from Al-Suhail, T *Minister of Health*: "We shall be the first country to apply cooperative health insurance to all residents", Middle East Newspaper on the 13 Feb. 2007.

From the Sharia aspect, many opinions (*fatwa*) were provided regarding the subject of insurance and the *Sharia* legality of the practical framework to be applied.

Whereas the conventional insurance currently organised in subjective thought as well as in business applications is deemed contradictory to Islamic Sharia in that its contracts may be full of *deceit (Gharar)*, usury and gambling.² Whereas, the insurance contract is associated with an investment contract which is an indispensable and inseparable contract, as the model of insurance and the collected capital of investment are funds accumulated with the insurer.³ Therefore the Saudi legislature has sought to issue an insurance system to be drafted in line with the law in Saudi Arabia based on Islamic Sharia.

In this chapter I will undertake the critical study of Saudi insurance law and its consistency with the Saudi regime and Islamic Sharia as a constitution for the Kingdom of Saudi Arabia.

4.2 The Insurance system and its consistency with the ruling regime in the Kingdom Of Saudi Arabia.

In Article (1) of the General Principles of the Statute of Governance Law in the Kingdom of Saudi Arabia it indicates that the Kingdom has taken as the Holy Quran and *Sunnah* of the Prophet (peace be upon him) as its constitution⁴ insofar as Article (7) of the Statute of Governance Law which provides that “Governance in the Kingdom of Saudi Arabia derives its authority from the Book of God Most High and the *Sunnah* of His Messenger, both of which govern this law and all the laws of the State.”⁵

In view of the preceding two articles, it becomes apparent that Islamic Sharia is the governor for the Saudi Arabian regime; and with regards to the Law on Supervision of Cooperative Insurance Companies, we reveal that Art. 1 stipulates that "Insurance in the Kingdom shall be undertaken through registered insurance companies operating in a cooperative manner as is

² See Chapter 1 from pp.48 -51.

³ See Chapter from pp.27 - 46.

⁴ The Basic Law of Governance. (2003) Part one, General Principles, Art.1, Translation of Saudi law, Series 2, pp.17.

⁵ Ibid, (2003) Part two, System of Governance, Art.7. , Translation of Saudi law , Series 2, pp.18.

provided within the article establishment of the National Company for Cooperative Insurance promulgated by Royal Decree M/5 dated 17/5/1405 H, and in accordance with the principles of Islamic *Shari'a*.”⁶ We clearly find that such an article has undertaken two issues:

- It has been confined to dealing with the cooperative insurance style and such has been constrained by the Statute of the National Company for Cooperative Insurance. Thus a general statute of a state cannot be enacted in accordance with any commercial company which is made as the original basis; especially as applications of this company and its statute can be criticised by many experts in Sharia and Islamic finance.
- However, the wording of the system should have been built on certain grounds consistent with the ruling regime to which all insurance companies are subject.
- The article has however, added that: “and in accordance with the principles of Islamic *Shari'a*.” Thus such an addition is definitely in line with the regime in the country based upon the fact that the legislature when drafting such a system has been aware that system of the National Company for Cooperative Insurance can be criticised as far as the Sharia scholars in the Kingdom are concerned.⁷ However it would be better to word such an article in the following manner in order for it to be drafted and read:

"Insurance in the Kingdom of Saudi Arabia should be conducted through registered companies working in conformity with a cooperative insurance style consistent with Islamic Sharia provisions."

Hence, it has become apparent that there has been a significant error in the constitutional drafting for such a regime for which many people who are interested in insurance have undergone a state of contradiction. With regards to the statute of any company, agreed upon by many researchers, this relates to the insurance business which is forbidden in some applications and is provided by the system as an example which should be traced; thus a new

⁶ SAMA. *Law on Supervision of Cooperative Insurance Companies* (2003) Art.1, (Online), Available: http://www.sama.gov.sa/sites/samaen/Insurance/InsuranceLib/4600_C_InsuraLaw_En_2005_08_17_V1.pdf

⁷ Many Sharia scholars consider the applications of the National Company for Cooperative Insurance to be a conventional insurance and not a cooperative insurance, and therefore not comply with the cooperative insurance model that been mentioned in Islamic *Fiqhi* Academy of the Muslim World League (1969) decisions. For more information refer to *Fatwa*, Online (Available): <http://www.alifita.net/fatawa/fatawaDetails.aspx?BookID=3&View=Page&PageNo=5&PageID=5664> 17-08-2012

addition is included in Islamic Sharia as stated in regards to provisions that raise a significant number of legal questions:

The questions are now as follows:

- Is adding or incorporating Islamic Sharia in such a regime intended to be the governor for all articles in the regime, or only as a literary text insertion, which is not contradictory with the provision of the Basic Law of Governance, i.e. Articles 1 and 7?
- Does the role of Sharia scholars in the evaluation of texts prior to their issuance make no longer diverge with Islamic Sharia?
- What is the role of legislative bodies in administering the formulation of such a system to ensure that it has been published with many legal violations?

I have not revealed follow-up procedures for the issuance of the system, or any effective or active role for Sharia scholars; but there is a dependence of the legislator upon the legal opinion of senior scholars in Saudi Arabia with regards to cooperative insurance,⁸ this varies in content from technical applications of the present system.

I attempted to explore the information, and wrote to legislative bodies such as the *Shura* Council and the Panel of Experts of the Cabinet⁹ which are the concerned authorities in the State to issue and adopt such laws. Therefore I posed questions to the authorities above, and others, and they responded by telephone but had no answer for such questions. It was deemed sufficient for me to personally ask these questions with reservation with regards to the answers which were given. From a personal perspective this was not convincing.

4.3 Characteristics of the Insurance policy in the Saudi regime:

The cooperative insurance contract in view of the provision of Article.1 of the Implementing Regulations of the Law on Supervision of Cooperative Insurance Companies consists of (The

⁸ To find more about the legal opinion of senior scholars in cooperative insurance see El Qora Daghi.A (2006). Islamic Insurance. Dar Albashaer Alislamia. Burit, Lebanon. pp. 135.

⁹ A copy of the letter presented to the Panel of Experts of the Cabinet has been attached in the appendix. This has been written in Arabic.

insurer which is an insurance company that accepts directly from the insured, and the insured which is a natural person or legal entity who has signed an insurance policy with the insurer.¹⁰) Thus the insurance contract is formed upon the basis of two main relationships as outlined:

- A. The relationship of a certain insured person with others who are insured collectively and represented by an insurance company; and a relationship of an insurer with an insured person. This is stated in Article 1 of the Implementing Regulations of the law on supervision of cooperative insurance companies; whilst defining the insurance policy as: (Legal document/contract issued to the insured by the insurer setting out the terms of the contract to indemnify the insured for loss and damages covered by the policy against a premium paid by the insured).¹¹ In the definition of insurance it is: a (Mechanism of contractually shifting burdens of pure risks by pooling them).¹² This is the most important relationship, because the characteristics of such a relationship are the origins for the provision of promulgation or nullification of such contracts.

- B. The relationship of the insurance company with the insured in particular. This regards the administration and management of insurance operations, such as the collection of contributions towards payment of compensation, and investment of contributions. That is the existing relationship between the company and the remainder of insured persons. The relationship upon which many researchers are focusing is on the expense of the first relationship. Therefore, I am firstly going to identify the legislative characteristics of the first relationship; and subsequently I will discuss the *Sharia* qualification of the second relationship.

¹⁰ SAMA, *The Implementing Regulations of the Law on Supervision of Cooperative Insurance Companies*, 2004, (Online), Available: <http://www.sama.gov.sa/sites/samaen/Insurance/Pages/LawsandRegulations.aspx>

¹¹ Ibid article 1.17.

¹² Ibid article 1.12.

4.3.1 THE CHARACTERISTICS OF THE RELATIONSHIP BETWEEN A SPECIFIC INSURED PERSON, AND THE REMAINING POLICY HOLDERS

Insurance companies in Saudi Arabia adopt the cooperative or mutual insurance system as a basis for its work. Therefore, its contracts may be believed to be some form of voluntary contribution, based on existing general opinions which include cooperative or mutual contributions under the title of contributions. From a personal perspective providing for a particular principle in particular does not mean that every application for such a principle will be characterised as such and hence, the study of these existing contracts is the best way to judge them as some sort of financial reimbursement, or donation, and for judging the existing *deceit (Gharar)*.

Gharar can be related to obscenity which is forbidden; or to *deceit (Gharar)* which can be overcome from the viewpoint of Islamic jurisprudence.

As has been noted in the preceding chapter, the basic principles of a commercial insurance policy consist of it being a civil contract which includes financial reimbursement and provision for compliance and obligation for both parties. In addition to being viewed as a temporary contract, along with other important principles, it has however been the subject of attention for Sharia scholars through analysis and criticism, and has been a direct reason for prohibition of insurance for the fact that some such principles can lead to *deceit (Gharar)*, usury and gambling.¹³ Therefore, can insurance systems in Saudi Arabia be giving Islamic solutions consistent with the principles of Islamic Sharia?

Insurance company policies in Saudi Arabia provide for the existence of a cooperative insurance relationship between the total number of insurance policyholders. This means that the company is not the original party for the contract, but is the agent for a group of policyholders in the management and organisation of insurance operations. Therefore, they impersonate the insured status in order to be acting for them, and thus each retains the character or capacity purely for the insured.¹⁴ Therefore the characteristics associated with the contracts of these companies regards the characteristics of the existing relationship between a

¹³ See Chapter 1, from pp. 39 -49.

¹⁴ See Takaful, A. (2011) Insurance policy for comprehensive car insurance Published by Alrajhi Takaful Company, article 1 (112).

certain policyholder and the remaining policyholders represented in the insurance company. Therefore does this mean that the policy holder should pay the premium amount due for the remaining policyholders represented in the company for financial reimbursement? Therefore would they deserve the amount of insurance according to the financial reimbursement, or would they pay the premium of contribution to provide help to whoever needed this from the total policyholders? Subsequently they would deserve the amount of insurance contribution due to their proper capacity as a beneficiary thereof. This could be identified through various conditions upon which contracting takes place, as described by the so-called insurance policy. In some insurance policies conditions do include explicit provision based on the fact that a premium is a contribution to help whoever requires it from the policyholders and some who do not.¹⁵

Some opinions have stipulated that a contract is a form of voluntary contribution. But, perhaps the remainder of the conditions may be doing so without such a condition. However, there is clear evidence to signify that there is an intention to donate or cooperate among those total insured persons to bear the risks which may afflict them. There may also be certain evidence and provisions regarding the will of financial reimbursement, and therefore such a provision is an insufficient indication that a premium is a donation. By reviewing the provisions of such policies, it may be possible to clarify the characteristics of such policies as follows:

4.3.1.1 Financial reimbursement contract (Muawadah)

Imam Malik views financial reimbursement contracts as “Acts and practices resulting in the development of funds, and what it is meant by collecting the same.”¹⁶ They are actions through which money is exchanged with other money; and those financial reimbursement contracts can be defined as such contracts whereby both contractors take an amount corresponding to what has been given, wherein each party is designed to get what the other has for acquisition purposes.¹⁷ Both parties of financial reimbursement are policyholders and the insurance company on behalf of the remainder of the policyholders; whereas the two opposite payments of financial reimbursement take part in the premium and the compensation.

¹⁵ Ibid. The introduction.

¹⁶ The second conference for Alazhar research Academy (1970), V. 2, from pp.152-164.

¹⁷ Aljorf, A S. (2009) ‘*The Evaluation of Saudi Insurance Systems*’. An Arabic paper presented in cooperative insurance conference in Riyadh, (Online) Available: <http://iifef.com/files/taameen/17.pdf> pp. 55.

Therefore we have four pillars for the financial reimbursement operation: an insurer (the company); a policyholder (the insured); a premium and compensation. Therefore we can devise this character from insurance systems in Saudi Arabia in view of the following:

- The Implementing Regulations of the Law on Supervision of Cooperative Insurance Companies in Article 1 (paragraph 17) thereof, has defined the insurance policy as: (A legal document/contract issued to the insured by the insurer setting out the terms of the contract to indemnify the insured for loss and damages covered by the policy against a premium paid by the insured).¹⁸ This is an express provision of financial reimbursement, as both parties take a corresponding share of what they have been given.
- Article 1 of the Implementing Regulations of the Law on Supervision of Cooperative Health Insurance has defined a premium as: An amount to be settled to the company by the policyholder in return for insurance coverage provided by the policy during the period of insurance.¹⁹ This is also an express provision of financial reimbursement; whereas the article states that the premium is paid in return for the amount of insurance.
- Article 1 of the Implementing Regulations for the control system of cooperative insurance companies has defined premium as: An amount offered by the insured to the insurer in exchange for the insurer's acceptance to indemnify the insured for loss/damages resulting directly from a covered risk.²⁰ This is an express provision of financial reimbursement; whereas the article states that the premium is paid in return for the amount of insurance.
- The comprehensive vehicle insurance policy of the *Tawnia* insurance company in the terms of Section II has stated: The company is committed in the event of an accident within the territory of the Kingdom of Saudi Arabia which has resulted or is resulting from the use of the vehicle of the insured to compensate the insured within the limits of responsibility set out in the schedule of policy for all amounts accrued to the insured,

¹⁸ SAMA .*The Implementing Regulations of the Law on Supervision of Cooperative Insurance Companies*, (2004), supra footnote 10.

¹⁹ SAMA .*The Implementing Regulations of the Law on Supervision of Cooperative Health Insurance*. (Online), Available: <http://www.cchi.gov.sa/en/Rules/Documents/Rules%20and%20Regulations.pdf> retrieved on 15-08-2012.

²⁰ SAMA. *The Implementing Regulations of the Law on Supervision of Cooperative Insurance Companies*, supra footnote 10.

or the driver is legally authorised to be paid as compensation for ...).²¹ This compensation to the insured is considered as a financial reimbursement in return for the contributions paid by them.

- As stated in the same policy, in section III in extensions: It could be for an additional amount to be paid to the premium, extending the coverage of the policy to include the following:
 - A. Extending the personal accidents.
 - B. Extending the geographic area.
 - C. Extending the age group.
 - D. Extending the non-application of consumption conditions in the case of compensation for total loss).²²

The preceding paragraphs confirm the financial reimbursement. Therefore extending the insurance coverage is an amount to be paid by the insured in return for an additional premium. Therefore, the above paragraphs are explicit provisions of financial reimbursement.

Aljorf (2009) has stated that the contract is being subjected to the principle of compensation. This means that the intent of the contract is: Returning the insured to the economic situation prior to the occurrence of the risk. Thus the insured pays the premium which they are to obtain from the company which returns them to the economic situation that existed before the occurrence of the risk.²³

This is in addition to the fact that insurance policies are void of any express provision, or presumption, which would indicate donation.

4.3.1.2 Binding contract for both parties:

The contracts of cooperative insurance companies are binding for both parties. The two offset obligations lie in the commitment of the policy holder to pay the required premium, and commitment of the company in return, to compensate the beneficiary when danger has occurred. Thus such obligations offset each other. Both are caused by the presence of the

²¹ Tawuniya, *Al-Shamel Commercial Policy Wording*, (Online), Available: <http://www.tawuniya.com.sa/GetFile.aspx?id=781> , retrieved on 15-08-2012.

²² Ibid.

²³ Aljorf, AS. (2009) *The Evaluation of Saudi Insurance Systems*, Supra footnote 16, pp. 58.

other, and the consequential impact at the same time; and this is clearly indicated by the phrases contained in the preceding paragraph which signifies that a contract enters under the heading of reimbursements.²⁴

4.3.1.3 Contract of submission:

The insurance company in this system is the stronger party, and the insured do not have the authority to waiver the conditions of the company, i.e. pre-printed conditions by the company and by compensating everyone, and therefore the insured persons are only required to sign a printed document, without discussion of its terms. They are not provided freedom with the exception of choosing between insurance or not. Whoever is willing to insure should sign via the company terms, and there is no difference in this respect between such a type and traditional commercial insurance.²⁵

4.3.1.4 Insurance is a probable contract or a contract of deceit (*Gharar*):

The probable contract or *deceit (Gharar)* contract is defined according to Islamic jurisprudence literature, with many definitions, which include:

- “A doubtful obtaining one of its financial reimbursement, or the often purpose intended thereof.”²⁶
- “A contract when a contractor does not know what he possessed, yielding what he has given.”²⁷
- “What cannot be entrusted obtaining a financial reimbursement.”²⁸
- “Deciding upon two matters, one for a purpose and the other for the opposite.”²⁹
- “What is apparently desirable, and in fact detestable”³⁰

²⁴ Ibid. Also see Chapter 1, pp. 25.

²⁵ Ibid.

²⁶ Alhattab. *Mawahib aljaleel fi sharhh mukhtaser alkhaleel*, Dar alfikr edition 3 Beirut (1992), vol. 4, pp. 362. Available (online): http://www.islamweb.net/newlibrary/display_book.php?ID=1&bk_no=19&idfrom=1&idto=4804 retrieved on 15-08-2012.

²⁷ Abdulkareem Alrafiyee, A. (1226) *Fattih Alaziz sharhh alwajeez.*, Dar Alkutub Alilmiah, Beirut (1997). Vol 8, pp.127.

²⁸ Algailooby (no date) *Hashiat Algailooby ala sharhh almuhallal lil alminhaj*, Dar alfikr for puplishment, Cairo, vol. 2, pp. 162. Available (online): http://bib-alex.com/23_7.php, retrieved on 15-08-2012.

²⁹ Alhattab , vol. 4, pp. 368 pp. 368, Supra footnote 26.

The upshot of the above definitions and reviewing the contracts of deceit (*Gharar*) or probable contracts in Islamic jurisprudence is that they are clearly financial reimbursement contracts. Thus they are infested and dominated with deceit (*Gharar*) until they are described as such, because if something ranges between two attributions, it cannot be described by one of them regardless of the other unless it is specifically and mostly significant part of it,³¹ Even If financial reimbursement is not carried out in whole or in part favour of a party to a contract. Contracts of deceit (*Gharar*) in Islamic jurisprudence are described under the heading of financial reimbursement, despite the lack of implementation of one the two opposing commitments, in part or in whole. Thus what counts is the introduction of the contract under financial reimbursement or donation; but under the intention and desire of the contractor and at the time as the contract. Therefore, deceit (*Gharar*) in insurance contracts is deemed to be an obscene deceit (*Gharar*) for the following reasons:

- A. Introducing insurance contracts under the definitions of deceit (*Gharar*), as insured, in cases of contracting may suspect receiving the amount of insurance, as this depends on the incident likelihood of occurrence in the future, which may or not occur. Thus the insured may or may not obtain entirely or partially the amount of insurance; or experience the possibility of obtaining the amount of insurance, whether or not it is equal, either likely or not for each other, which is not known until after the danger occurs, as there is no other result than obtaining an insurance amount or not.³²
- B. The availability of certain controls of obscene deceit (*Gharar*) in the insurance contract:

Aljorf (2009) has stated that it is often discussed among the *Maliki* scholars that deceit (*Gharar*) which invalidates financial reimbursement contracts may be divided into seven areas, such as: deceit (*Gharar*) in existence, incidence and in terms of the amount. As well as deceit (*Gharar*) with regards to time and price. Therefore when applying such controls within an insurance contract it shows the following:

³⁰ Mohammed Aldosoogy, M. (1230H). *Hashiat Aldosoogy ala alsharhh alkabeer*. Dar alfikr for puplishment, Beirut, vol. 3, pp. 55. Available (online): <http://www.almeshkat.net/books/open.php?cat=39&book=1229> , retrieved on 15-08-2012.

³¹ Ibn Rushd Alhafeed.(595H).Bidait-ul-almujtahid. Ibn hazim for publishing (1999). Cairo.vol. 2, pp. 547.

³² Alhamid.H.*The verdict of Shari'a on Insurance*, Dar Alitsam, Cairo, pp. 45- 46.

- Deceit (*Gharar*) in existence: Availability exists in the insurance contract, because the amount of insurance is a debt to be paid by the insured that is not certain. This is because its existence depends on the existence of the insured risk, if any it would be found, and if not it would be null.
 - Deceit (*Gharar*) in obtaining: The insurance contract contains *deceit (Gharar)* in obtaining, because the contractor does not know whether they will obtain the amount of insurance or not, and the premiums they have paid. This is because this obtaining depends on the potential or not of an incident.
 - Deceit (*Gharar*) in the amount of compensation: This contains an amount of compensation, because the insurance company may obtain a single premium and then a disaster may occur. Therefore it will be obliged to pay the amount of insurance in whole or in part; whilst a large number of premiums will have been paid to the insured before the accident had occurred. Thus there is a significant difference between both cases of up to thousands of riyals. With regards to the insured, they are paid a fixed premium in exchange for a pledge by the company to pay a certain amount through which the premium will be determined. However the company may pay such an amount in full, or potentially half of this amount, etc depending on the gravity of damage which has occurred.
 - *Deceit (Gharar)* in term: Insurance contracts contain *deceit (Gharar)* in order to obtain compensation. "The amount of insurance is a commitment to be honored by the insured that may be added for a non-determined term, and this is clearly shown in some forms of life insurance, so that the insurance company is committed in this type of insurance to pay an insurance amount upon the death of the insured, which is for an unfixed date.³³
- C. The lack of controls of easy *deceit (Gharar)* in the insurance contract: Such controls were stated in view of some Maliki scholars whereby: "An easy *deceit (Gharar)* is forgiven for need, i.e. necessity, or if it is not meant, or non-intentional." Examples of easy *deceit (Gharar)* can be related to the foundations of a house which may have been bought without an understanding of its depth, width or durability; and its lease over a period of months with a possible decrease in months. Thus the scholars devised certain conditions for an easy *deceit (Gharar)* as outlined:

³³ Aljorf, AS. (2009) *The Evaluation of Saudi Insurance Systems*, Supra footnote 16, pp. 60 -61.

- a. Easy *deceit (Gharar)*: When the increased or decreased of the amount of compensation is little, as set by the two contractual parties as compared to the total value of the compensation,
- b. When the commission of *deceit (Gharar)* is necessary to prevent the same situation which could cause great embarrassment or excessive harm to people.

In applying such conditions to the insurance contract, we find that these controls do not apply.

4.4 Legislative qualification of the Insurance company in collecting and investing contributions as well as payment of compensations

Evaluation of the legislative qualification of the insurance company in collecting and investing contributions as well as payment of compensations, according to Aljorf (2009) will clearly find that the control system for insurance companies and its Implementing Regulations, or the System of Cooperative Health Insurance Council and its Implementing Regulations, or the Corporate System of the company itself, or Articles of Association, do not provide for the qualification of this relationship. It is not otherwise provided by applicable insurance policies.³⁴ However I do think that this relationship could be qualified by reviewing functions performed by the company and the returns obtained in return for this, which may be determined as follows:

- A. Article 1 of the Law on Supervision of Cooperative Insurance Companies has stated that “Insurance in the Kingdom shall be undertaken through registered insurance companies operating in a cooperative manner as is provided within the article establishment of the National Company for Cooperative Insurance promulgated by Royal Decree M/5 dated 17/5/1405 H; and in accordance with the principles of Islamic Sharia.”³⁵
- B. Article 3, paragraph 2 of the Law on Supervision of Cooperative Insurance Companies: The main object of the company shall be to engage in any of the insurance and reinsurance activities, and not to undertake any other activities unless they are complementary or necessary. Insurance companies may not directly own brokerage companies or establishments. Re-insurance companies may not also own re-insurance

³⁴ Ibid, pp. 62.

³⁵ The Law on Supervision of Cooperative Insurance Companies, SAMA, supra footnote 6.

brokerage companies or establishments. However, insurance companies may, subject to obtaining the Agency's approval, own companies or establishments engaged in re-insurance brokerage activities.³⁶

- C. According to Article 6 of the Statute of Insurance Company's form established by the Saudi Arabian Monetary Agency (SAMA) "The company invests the accumulated funds of its insured and shareholders in the company in accordance with established rules by the Board of Directors."³⁷
- D. However, the Tawuniya Insurance Company stated in their annual report of 2010: in paragraph (b) Principles of presentation: The company maintains separate accounting books for each of the accounts of insurance operations as well as accounts of shareholders. So, all required revenues and expenses for each type of business shall be recorded in the relevant accounting records. Also, all expenses related for common operations performed by the management and members of the Company's Board-of-Directors shall be distributed accordingly.³⁸
- E. Surplus and its distribution: Article 1/36 of the Implementing Regulations of the Law on Cooperative of Insurance Companies has defined the formula of surplus distribution as: "A method by which profit of insurance and reinsurance companies is distributed among shareholders and policyholders."³⁹ Furthermore, under Article 70/1 of the same regulation it has stated that "The Company's financial statements, at a minimum, shall consist of; statements of financial position for insurance operations and shareholders accounts, profit and loss statements for insurance operations, shareholders' income statements, statement of shareholders' equity, statements of cash flows for insurance operations and shareholders' cash flow statement."⁴⁰ In addition, the article has defined certain matters which should be taken into account when preparing the list of insurance operations, namely:
- a) "Determine earned premiums, and income generated from reinsurance commissions, and other insurance operations revenues.

³⁶ Ibid.

³⁷ SAMA. *The Statute of Insurance Company's Form (2007)*, (Online) Available: www.sama.gov.sa/InsuranceLib/Forms/AllItims.aspx

³⁸ The National Company of cooperative Insurance (NCCI) *Tawuniya. The annual report of (2010). Notes to The Financial Statements, Principles of Preparation*, p69.

³⁹ The Law on Supervision of Cooperative Insurance Companies, SAMA, *supra* footnote 6.

⁴⁰ Ibid

- b) Determine the incurred indemnification.
 - c) At the end of each year, the total surplus representing the difference between (a) and (b) less any marketing, administrative expenses, the necessary technical provisions, and other general expenses related to the operation of insurance shall be specified.
 - d) Company's net surplus shall be determined by adding or subtracting the investment return of the policyholder's invested funds, and subtracting the general expenses related to the policyholder's portion of the investment activities."⁴¹
- A. Net surplus is distributed according to Article 70/2.e of the Implementing Regulations of the Law on Cooperative of Insurance Companies whereby "10% of the net surplus shall be distributed to the policyholders directly, or in the form of reduction in premiums for the next year. The remaining 90% of the net surplus shall be transferred to the shareholders' income statement"⁴².

4.4.1 THE COLLECTED RETURNS BY THE COMPANY:

The preceding paragraphs indicate the existence of two types of revenue charged by the company:

1. Return for its management and organising insurance operations, this includes collection of contributions and investing them together with the paying out of compensation, etc., such as actual expenditures, which are always payable.
2. A return of 90% of the net earned surplus.

However, the regulation has not clearly indicated the work carried out by this company as opposed to the surplus.⁴³

⁴¹ Ibid. article 70/2

⁴² Ibid. Article 7/2.e

⁴³ Aljorf, AS. (2009) *The Evaluation of Saudi Insurance Systems*, Supra footnote 16, pp. 64.

4.4.2 THE ISLAMIC JURISPRUDENTIAL (FIQHI) ANALYSIS OF THE INSURANCE COMPANY, ACCORDING TO THE INSURANCE SYSTEM IN SAUDI ARABIA:

After reviewing works undertaken by the company for the benefit of policyholders, checking the returns collected by the company, in return for performing such works, it can be said that the contracts of this company consist of two main inseparable pillars, namely:

4.4.2.1 Agency contract with fixed payment

The company in this contract undertakes a significant amount of responsibilities such as management, organisation of operations of insurance, collection of contributions and payment of compensations; as well as other matters related thereto. However, it is well known within mutual or cooperative insurance, that the policyholders are the insurers and are insured at the same time; and that the company is engaged in the collection of contributions and payment of compensation to beneficiaries on their behalf. This is because it takes the capacity of the insurer, and each party only keeps the capacity of the insured, so that it may arise between the company and the policyholder an agency contract in view of this matter.

The Agency in Islamic Sharia is “an empowerment proxy to act in what is related to rights of Allah⁴⁴ as well as the rights of humans.”⁴⁵ That which is held by the company is appointed as a proxy of the rights of humans, or rather a contract of agency, for a temporary known duration, which is often one year, based upon a future condition with respect to the payment of the compensation. However, paying compensation is pending upon the occurrence of danger, whereas it is only paid after the incident which is deemed religiously permissible.⁴⁶

An agency has many applications which are pending, so it comes pending with a condition such as; “If the winter comes get a health insurance to my mother”. Also pending with time such as “I will assign you my agent for one month.”⁴⁷ The policyholders at the time of signing the contracts should entrust the company in terms of the collection of contributions

⁴⁴ This applies in pilgrimage (*Hajj* for example) Therefore in the case of illness when one would be unable to perform or complete Hajj they could ask another to perform or complete it on their behalf.

⁴⁵ Albahooty. *Kashaf Algenaa. almaktabbah alislamiyah* for publishing edition D.T. (1982).Beruit. vol. 3, pp. 48.

⁴⁶ Ibid.

⁴⁷ Ibid.

and the payment of compensations to beneficiaries under the terms of policy. This is required as part of the process of calculating contributions and reinsurance, during a certain period, which is often one year, and this matter even not expressly provided for in the contract, but the concept of cooperative insurance practiced by the company stipulates that the insurance custom is required as there is a rule in Islamic law which states that “what is known as a custom is applied as a condition”, as if it was provided for explicitly in the contract.⁴⁸

Therefore, contracts are valid in all parts of their meaning according to custom, whether saying, acting or otherwise. Thus, what the company has taken as a return for facilitating such work will be determined at the end of the year based on actual expenditures of the company. Therefore the contract shall be held as an agency contract, and the agency with wages or compensation will be legally valid, whether paid or unpaid.⁴⁹

However, if the payment is not predetermined at the end of year it will become indefinite, and the paid agency is only valid if the payment has been known and has been determined at the time of signing the contract; because in this case it is a kind of financial reimbursement. Thus because of ignorance regarding the amount of compensation, an obscene *deceit (Gharar)* will arise and this will invalidate contracts of financial reimbursement.⁵⁰ However, where it is possible to determine that the actual expenditures of a company are similar, and actual expenses of the company for the past years should determine that pay in advance, or select ceilings for the lowest and the highest such expenses in the basic system, to enable the policyholder to read or to be placed in the form of a supplement to the policies. Determining the return in advance would deny the *deceit (Gharar)* of the contract, and subsequently it would not be subjected to annulment, nor would it allow the company to significantly exceed its expenditure as a lack of determination of return in advance. However, it could list all the subscriptions and revenues, under actual expenditures, and so could cause policyholders to experience losses.⁵¹

⁴⁸ Ibid.

⁴⁹ Ibid. V 3 p 489.

⁵⁰ Aljorf. AS (2009) .*The Evaluation of Saudi Insurance Systems*. Supra footnote 16. P 66

⁵¹ This matter really happened. Therefore refer to the auditor’s report in the annual report for the Tawuniya Insurance Company (1987), pp. 17.

4.4.2.2 *Mudarabah contract:*

The relationship between the company and the policyholders at first glance, is an *Anan company*⁵² and a trading company *Mudarabah* at the same time, with regards to invested contributions that have been accrued. This is religiously permissible, as separate contracts are permissible, and can be combined together in one contract. In accordance with Albahooty (1051H) in defining the *Anan company* as having two types. Thus⁵³ one of which “involving two or more funds, to be staffed by one provided that its profit is more”; and “The company, which applied this contract has two conditions: the first is *Anan* when considering that the money is paid by both parties; and the second is (*Mudarabah*) trading off whereby that work is from one party plus a profit on its money, as the work of one of the wealth of others, and part of profit.”⁵⁴

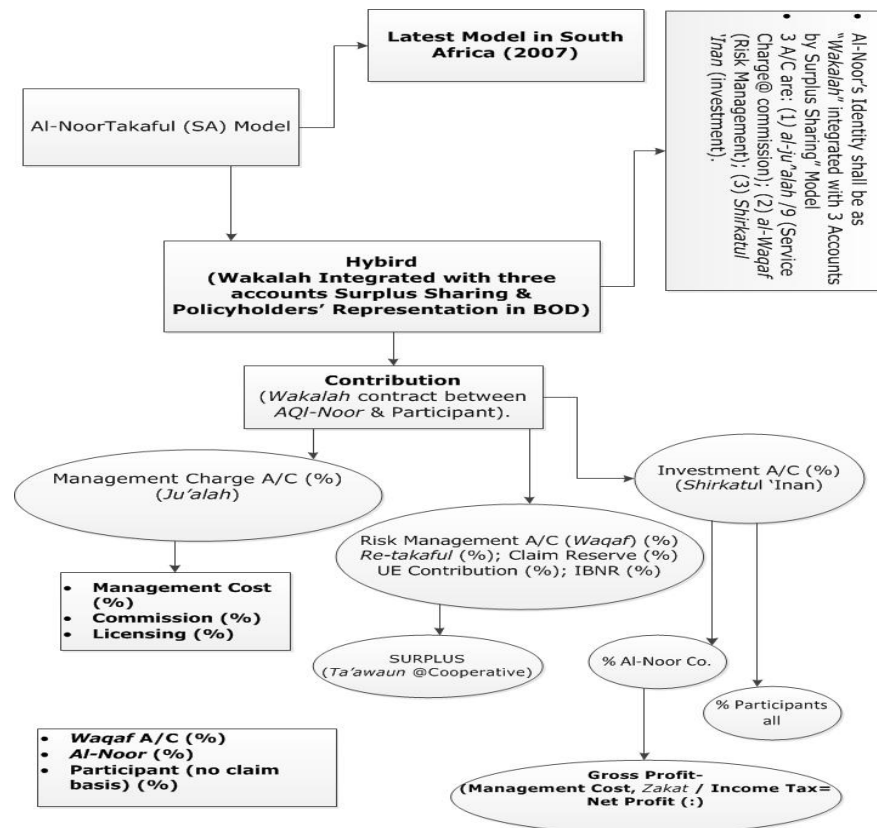


Figure 4.1: Model applied in Al-Noor Takaful in South Africa.

⁵² In Islamic *fiqhi* it is a partnership whereby both partners invest a definite sum of money and definitely profit share. Please refer to Ibn qudamah Almaqdisy(1223AC)(620H). Almugnee, Dar alcutub for publishing, edition 3, 1997, Beirut., Ibn Rushd Alhafeed.(595H).Bidait-ul-almujtahid. Supra footnote 31, vol. 2, pp. 269.

⁵³ All that is needed in this regard is type one as an important addition; and there is no need to mention type 2.

⁵⁴ Albhooty. (1982) *Kashaf Alqinaa*. Supra footnote 44, vol. 3, pp. 497.

Thus in the insurance company the money is submitted by contributors, policyholders, and work that is carried out by the company. This means that the work is done by the shareholders for the benefit of all parties, against a certain percentage of profit, to be taken from the profits of the insured after the distribution of a certain amount of profit at the beginning.⁵⁵

However has this contract really been applied in Saudi Arabia? To properly answer this question, there should be a review of pillars and conditions of its validity in Islamic jurisprudence to determine how it applies to this contract.

A. The pillars of trading off the (*Mudarabah*) contract must be applied in the contract:

Mudarabah has three pillars in Islamic jurisprudence which are: contracting parties, the form, and the subject.⁵⁶

1. **Contracting parties:** Represent the company as the first contractor, and the policyholder as the second contractor. Thus the first pillar of trading is achieved.
2. **The Form:** The contract takes a written form which is legally permissible. Whereas trading is held for all evidence of its customary meaning, whether said or written. This is because the purpose is related to the meaning of the transaction on this matter.

Can we derive the meaning of trading of *Mudarabah* from insurance policies issued by the company?

An insurance policy is the primary source through which to identify the intention of the insured associated with the contract, through the form of the contract, and their own words. Therefore, there is no such indication or mention of *Mudarabah* in the company policies, or intentionally manipulating or trading *Mudarabah* on the basis of the parties; but as explicit provisions which are the intended basis of the contract for the insured to collect the amount of insurance at the time of particular risk described in the contract. Therefore trading or

⁵⁵ Aljorf. AS. (2009) *The Evaluation of Saudi Insurance Systems*, Supra footnote 16, pp. 66.

⁵⁶ Ibn qudamah Almaqdisy(1223AC)(620H). Almugnee , supra footnote 52, vol. 5, pp.20. However, it has been an argument between Fiqhi schools on the number of *Mudarabah* pillars, so *Hanafi* considers it tow, *Maliki* and *shafie* they stated four and finally *Hanbali* confirms five. And in my point of view i think the three pillars mentioned above are the most affective factors in this transaction.

investment of money is not intended for itself, but is a continued complement, for the purpose of the basic contract, and signing the document of acceptance from the insured with all its contents consider an acceptance of the rules of the foundation in general, and in particular Articles showing that the purpose of the company is to carry out the regulation of cooperative insurance. It may have all that it has to do so as to achieve this purpose, such as: investment in funds accumulated as a result of the participation of the insured, also the existence of trading as a secondary intention of the contract is a custom of insurance companies. Therefore, the custom of insurance companies is to retain a portion of the contributions collected in order to settle daily payments, and invest therein, but as this custom is not known by many of the policyholders and the system is essentially impossible be found in different condition for many people. It must be noted in the insurance policies that there is trading *Mudarabah* as a complementary intention, or an assistant to complete the basic intention in insurance, and making all required articles on investment process in the form of an annex to the insurance policy⁵⁷.

3. **The subject:** That which is held as trading in capital as well as work⁵⁸, and is realised here in the insurance company contract, as the insurance contributions as collected from the insured, and the work products of the company in this area are to the benefit of policyholders. Therefore, trading *Mudarabah* is not fixed in all respect of contributions, because trading is not the main intention of the contract, but is fixed for the remainder of contributions after the allocation of the conventional component to pay future potential compensations⁵⁹.

B. Conditions of validity for *Mudarabah* contracts must be applied to the contract:

Scholars have provided for some conditions to validate Mudarabah contracts, notably:

⁵⁷ Ahmed Saado Aljorf (2009) *The Evaluation of Saudi Insurance Systems*. Supra footnote 16. P 67

⁵⁸ Capital and work considered as a separate pillars in *Maliki, shafee* and *Hanbali* Schools.

⁵⁹ Alkhwaiter. A 2005. *AlMudarabah in Islamic Sharia.Arabic*.Dar almaseer. Dammam.2005 1st edition.p 40. Aladawee.A 1992. *Hashiaat Aladawee*. Dar alfikir. Beirut.1992.v2 p266. Alabdary.M 1398H.*Aljaj wall Ekleel*. Dar alfikir. Beirut. No date. Alsharbeeny .M.*mugny Almuhtaj*. Dar alfikir. Beirut. No date. V2p 117.Alsaid. A. *Eaanat Altalebeen*. Dar alfikir. Beirut. No date.v 3p99. Alshafee .1984. *Nihayat Almuhtaj*. Dar alfikir. Beirut.1984. v5p5. Musa. M1998. *Privet Companyin Sharia and Law.Arabic*. Dar Alasima. Riyadh 1998.2ed edition. p58. Ibn qudamah Almaqdisy(1223AC)(620H). Almgnee. supra footnote 52. v 5 p20.

1. Capital should be in cash form⁶⁰. It is recognised that all contributions or premiums are considered as trading capital in the *Mudarabah* model, which always takes the form of cash.
2. Capital shall be a certain and known amount⁶¹, when making a contract, and this is not recognised here in this application for the following reasons:
 - **Private invested capital of the insured is composed of two main parts:**
 - A part allocated for collected contributions to meet daily claims, and one for trading and investment. It is this second part that constitutes the first section of the capital of the insured, which is relied upon, because it is always there and known to the company only, as there is no indication of its liquidity size in regards to insurance policies. It appears in the Basic System of the company, and in the annual accounting reports issued by the Company⁶², and also appears in the annual financial reports that provide details of the general investment income and not the invested capital exactly and its value⁶³.
 - The allocated portion of contributions or premiums is required to meet daily claims by following certain technical guidelines. The allocated portion depends initially on estimation and expectation as based on particular information, and real previous statistics. Also, this does not necessarily mean that the part mentioned be used in full as compensation, it may also have part of that money left from a compensation fund, which can then be turned into investment, as is evident in the second section of the invested capital, allocated to policyholders. This is also an unknown amount for both parties prior to the termination of allocated time for this section, as is necessary to meet daily payments throughout this period. However, there is a difference between the gross written premium (GWP) which has been collected already from the insured and the net written premium (NWP), which is retained by the company itself after paying re-insurance and deducting whatever has been collected in the current period and is related to dangers faced in the coming year. It has been a custom among insurance companies to re-insure part of the policies issued by it, and so retain a portion thereof

⁶⁰ Albahooty. *Kashaf Algenaa. almaktabbah alislamiyah for publishing edition D.T. (1982).Beruit.v4 p82-84.*

⁶¹ *Ibid. v4 p498-507.*

⁶² I tried to find this figure by reviewing the Annual report 2011 of Tawuniya's Company, which is the biggest insurance company in Saudi, to assure this information and found as it confirmed above.

⁶³ Aljorf. AS (2009) *The Evaluation of Saudi Insurance Systems*. Supra footnote 16. P 68

to be determined based on the financial capacity of the company based on some technical aspects. Further, this portion is not fixed but varies from year to year depending on certain circumstances. With this type of ignorance regarding the size of capital investment, subscriptions of reinsured policies represents a subtraction of the invested capital, and this is not known at the time of contracting with the policyholders. Normally it is not known until the end of year⁶⁴. Thus, this applications do not comply with the *Mudarabah* condition that confirms *Capital shall be a certain and known amount*.

- In the case of reinsurance ignorance applies in the case of the company's transaction. Some companies accept re-insurance operations policies issued by other companies; namely, these companies work as reinsurers and third party insurers. The consequences of this process is conversion of the contributions of such policies as accepted for reinsurance, minus what is paid for the company's original commissions (the second party), management expenses, and reinsurance of the company by a fourth party. Such contributions lie within the ownership of the insured (Takaful Fund) without the shareholders as soon as the contract is signed and the capital invested; thus, through this procedure an unknown sum is expected by the policyholders and the company⁶⁵. Thus, the capital is still not certain and known, and so does not comply with the rule of *Mudarabah* in Islamic Sharia.

- The two contracting parties must stipulate their share of the profit at the time of signing the contract, and this profit must be known as any specified percentage in advance on the contract, such as 10% for trader (*Mudarib*), and 90% for capital owner (*rabullmal*) or so on⁶⁶, but this is not realised here; as article 70 of the Implementing Regulations of the Cooperative Insurance Companies Control Law (IRCICCL) provided, the Company has the right to obtain 90% of the net surplus⁶⁷. Therefore, there are some observations to be made on this subject:

⁶⁴ Ibid.

⁶⁵ Ibid.P70

⁶⁶ Albhooty (1982). *Kashaf Alqinaa*. Supra footnote 60 .v4 P498.

⁶⁷ Saudi Arabian Monetary Agency.(SAMA) available online at:

http://www.sama.gov.sa/sites/samaen/Insurance/InsuranceLib/IIR_4600_C_ReguExecutive_En_2005_08_18_V1.pdf

- A. Surplus represents the difference between the total number of premiums and the incidences of compensation, less marketing, administrative and operational expenses and the cost for necessary technical provisions. Thereby, surplus is not a consequence of investment operations, of which the company would have no right to receive a portion. On the other hand, the company usually receives administrative expenses to cover their efforts. Therefore, some Islamic companies are stipulated to receive a part of the surplus due to the good performance of the company; this is as a reward for good performance and is linked to good financial and administrative performance in equitable proportion.
- B. Company's net surplus shall be determined by adding or subtracting the investment return of the policyholder's invested funds, and subtracting the general expenses related to the policyholder's portion of the investment activities⁶⁸. Furthermore, based on return on investment the company can get a part of this investment in the event of being a quality trade partner (*Mudarib*).

Accordingly, in view of the above, the relationship between the company and the total insured may be described as a fee based agency for the management and regulation of insurance with the *deceit (Gharar)* in wage, and thus the fee based agency contract is void. On the other hand, what is relevant to the investment of funds, is that the company is a joint trader (*mudarib*), thus each policyholder is an owner of the capital (*Rabuallmal*). Therefore, it is also an absolute trade, but one that is still restricted or temporary in terms of time because the contract period is only one year; therefore, I can confirm that according to Islamic rules of *Mudarabah* this fake application is void as well, for two reasons, the first is ignorance in terms of the amount of capital and the second is that the company will take a share of the surplus which it is not entitled to.

⁶⁸ Ibid.Art 70.d.

4.5 Legislative qualification of The Council of Cooperative Health Insurance (CCHI) in the Kingdom of Saudi Arabia:

To achieve the considerable critical legal analysis necessary for The Council of Cooperative Health Insurance function, we need to comprehend the tasks and duties as compared with the rights and whether these duties and rights comply with the Islamic Sharia rules and the constitution of Saudi Arabia. This qualification can be illustrated through the relevant articles and the description of the tasks performed by the Council will be received as follows:

- 1) Article IV.A of the CCHI rules stated: Health Insurance Council established under the chairmanship of the Minister of Health and the membership:
 - A. A representative at the level of Under Secretary of the Interior Ministry, the Ministry of Health, Ministry of Labour and Social Affairs, Ministry of Finance and National Economy, Ministry of Commerce, nominated by their destinations.
 - B. A representative of the Council of Chambers of Commerce and Industry nominated by the Minister of Commerce, a representative of the Cooperative Insurance Companies nominated by the Minister of Finance and National Economy in consultation with the Minister of Commerce.
 - C. A representative of the private health sector and two representatives from the health sectors and other government nominated by the Minister of Health in coordination with their respective sectors. These are appointed members of the Council and are to renew their membership by decision of the Council of Ministers for a period of three years, subject to renewal.
 - D. A representative of the private health sector, together with two representatives from the health sectors and other government officials nominated by the Minister of Health in coordination with their respective sectors.

Members of the Council are appointed and their membership identified by a decision of the Cabinet for a period of three years subject to renewal⁶⁹.

- 2) Article 5 of the same rules stated: The Health Insurance Council overseeing the implementation of this system, has to in particular do the following:

⁶⁹ The council of Cooperative Health Insurance Ruls. Article 4 available at: <http://www.cchi.gov.sa/en/Rules/Pages/default.aspx>

- A. Prepare a draft executive regulation of this system.
 - B. Issue the necessary decisions for regulating changes to the application of the provisions of this Regulation, including the identification of stages of the application, identifying family members of beneficiaries covered by the warranty and discerning how the percentage contribution of the beneficiary and the employer affect the value of participation in regards to cooperative health insurance, as well as to determine the upper limit of that value based on specialised study, include the insurance accounts.
 - C. Rehabilitation of cooperative insurance companies aiming to work in the field of cooperative health insurance.
 - D. The adoption of health facilities provides cooperative health insurance services.
 - E. Determine the fees for the rehabilitation of cooperative insurance companies to work in this area, and the fees for the adoption of health facilities that provide cooperative health insurance services, after ascertaining the opinion of the Ministry of Finance and National Economy.
 - F. The issuance of Financial Regulations to the Board of health insurance revenues and expenditures, including salaries and bonuses, after taking the opinion of the Ministry of Finance and National Economy.
 - G. Issuing internal regulations to regulate the functioning of the Council.
 - H. Appointment of the Secretary General of the Council as to the nomination of the Minister of Health, and the formation of a secretariat determining its tasks⁷⁰.
- 3) Article (57) of the Implementing Regulations of the CCHI stated: The Board shall control the comprehensive health insurance coverage, and make sure that the parties to the relationship of health insurance to the implementation of tasks and responsibilities entrusted to them under this Regulation⁷¹.
- 4) Article (58) of the same Regulation stated: The Council may request any information and data from the institution, insurance companies and other parties concerned with any matters pertaining to work on health insurance, and the Board in individual cases, especially with regard to items of public health insurance request forms and other publications used by the health insurance company in correspondence with employers,

⁷⁰ Ibid.

⁷¹ The Implementing Regulations of the Council of Cooperative Health Insurance. Art.57 available at: <http://www.cchi.gov.sa/en/Rules/OList/Pages/Chapter7.aspx>

beneficiaries and service providers as well as any contracts signed based on the management's company health insurance claims⁷².

- 5) Article (36) regarding the supervision fee was based on the statement: The fees for the Cooperative Health Insurance Council are intended to oversee the implementation of the cooperative health insurance system at one percent of the premiums for health insurance from insurance companies, as qualified by the audited financial statements for the previous year. This is so as to be considered in relation to the appropriate figure and the possibility of reduction after three years since the application in coordination with the Foundation.⁷³
- 6) Article (38) of the same Regulation describes the financial resources of the Council which state that the Council is funded through the following:
 - A. The fees for qualifying and annual renewal of insurance companies.
 - B. The fees for qualifying and annual renewal of the management companies and health insurance claims
 - C. The fees for the adoption of annual government health service providers and non-governmental organizations.
 - D. The fees for the Cooperative Health Insurance Council to use to oversee the implementation of a cooperative health insurance system with one percent of the premiums for health insurance; insurance companies are qualified according to the audited financial statements for the previous year.
 - E. Other financial fines are owed to the Council as well as required by the Commission for violations of the provisions of the cooperative health insurance specified in Article (101) of these Regulations.
 - F. Donations, gifts and investment returns.
 - G. The amount of money collected from other sources such as the publication of magazines, brochures, business consulting or training that may be carried out by the Council⁷⁴.
- 7) Article 46 relevant to the fees of the rehabilitation of insurance company, which is different from supervision fees, states that:

⁷² Ibid. Art 58

⁷³ Ibid, a

⁷⁴ Ibid.

- A. The Board shall receive a corresponding financial support for the rehabilitation of insurance companies, amounting to one hundred and fifty thousand Saudi Riyals only.
 - B. The Board shall receive a counter for the renewal of financial rehabilitation of the cooperative health insurance companies amounting to fifty thousand Saudi Riyals for each year required after the expiry of the first three years of rehabilitation⁷⁵.
- 8) However, Article 10 Rules for Collection of Financial Consideration against Supervision of Implementation of the Health Insurance Regulation stated. In the case that an insurance company makes delayed payment of the financial consideration, a delay penalty equivalent to (5%) shall be levied against the claim amount for each month or a part thereof..... and no objection by the company (if any) shall prevent payment of the delay penalties relevant to the Council's entitlement from the company, provided the Council shall issue a subsequent claim to the original one including the total amount of the delay penalties due⁷⁶.

Based upon the above, it is evident that the Board of the Council of Cooperative Health Insurance CCHI is not a party to the insurance contract, so it is a governmental supervisory body. Therefore, there is no relationship between councils and policyholders; these are paid in return for supervising insurance companies and the application of the Council of Cooperative Health Insurance rules regarding its Implementing Regulations, which represents 1% of total premiums. There are interesting observations on this subject as follows:

- a. It has been recognised that premiums or participants in a cooperative insurance concept belong to policyholders, not the insurance company; nor are they the property of state, and therefore, the Council has no right to cut 1% off the premium, unless it is prescribed in the rules that the Council is the agent for those policyholders in control of insurance companies and therein, which will be considered as an agent fee. It also has no right to this rate if the Council acts as an agent for insurance companies as well, because it should take this percentage from shareholders. Thus, it must be explicit in law what exactly the Council's relationship with both parties is in reference to holding health insurance.
- b. The Board will receive money from insurance companies in fines, as much as 5% of the claim following any delay by an insurance company in the payment of their supervision

⁷⁵ Ibid.

⁷⁶ Rules for Collection of Financial Consideration against Supervision of Implementation of the Health Insurance Regulation. Art. 10 available at <http://www.cchi.gov.sa/Rules/Pages/list3.aspx>

fee dues to the Board. This means that the Board is a creditor to the company in this claim. Thus, the fine is a usury *Riba*, which is religiously prohibited, this requires that an amount be increased by *Riba*, and this is evidence that there is a relationship between the Board and the insurance companies. The nature of the relationship is unclear, and whether the company is a party on its own behalf, or on behalf of policyholders or both is also unclear⁷⁷.

4.6 Surplus and its distribution:

According to the implementing regulations of Saudi cooperative insurance, there are two types of surplus, one of these is available for distribution, and the other is not to be distributed. We may clarify these two types as follows:

5.1 The Total Surplus:

This is as stated in Article 70 of the Implementing Regulations for Law On Supervision of Cooperative Insurance Companies: (premiums) - (compensation + marketing expenses, administrative, operational and technical provisions necessary)⁷⁸. It is not available for distribution, and this kind of surplus is not the result of efforts exerted by the company in the investment of the contributions.

Net surplus:

It has been to determine the net surplus as stated in the same article:

- Total surplus + (the return on investment of insured - the policyholder's portion of the investment expenses activities).

Or:

- (total surplus) - (loss of investment operations + share of the expenses of policyholders realized by investment)⁷⁹.

This kind of surplus is available for distribution and is distributed as follows:

⁷⁷ Aljorf.AS (2009). *The Evaluation of Saudi Insurance Systems*. Supra footnote 16. P 75

⁷⁸The Implementing Regulations. Saudi Arabian Monetary Agency.(SAMA). Art. 70 supra footnote 10.

⁷⁹ Ibid.

- A. The insured party gets a percentage of 10% ten percent cash or a reduction in their premiums for the following year.
- B. Shareholders get 90% ninety percent of the surplus, where this ratio is transferred to the statement of shareholders' equity.

In my opinion based on my research, there are some important observations regarding the distribution of surplus; these are as follows:

- a. The right to surplus applies to the policyholders because it is their own money and has been collected from their premiums.
- b. In case the shareholders and the Cooperative Health Insurance Council take something not allocated to them, and deprive policyholders of their rights; insurance companies get a part of the total surplus, which is one of the components of net surplus, which is not an income achieved by the company, and that is exactly the case for the Council of Cooperative Health Insurance.
- c. In case the shareholders and the Cooperative Health Insurance Council get a quota of the surplus in all cases, this in the form of positive or a negative investment returns i.e. in cases of loss. This has been cleared by the definition of net surplus (Company's net surplus shall be determined by adding or subtracting the investment return of the policyholder's invested funds, and subtracting the general expenses related to the policyholder's portion of the investment activities). It is considerably well known that the trader *Mudarib* in Sharia, loses as a result of his work investigating the loss. This is arguably an aspect of the company's relationship with policyholders regarding the investment of contributions, in a trading *Mudarabah* relationship; let alone with the absolute absence of such a relationship between the policyholders and the Council of Cooperative Health Insurance⁸⁰.

⁸⁰ Aljorf.AS (2009) *The Evaluation of Saudi Insurance Systems*. Supra footnote 16. P 77

4.7 Investment of Insurance Funds

The Implementing Regulations of Law On Supervision of Cooperative Insurance Companies has defined certain sorts type of investment funds, and percentages invested in each rate, as explained by some of the things related to investment as follows:

6.1 Article 60 of the Regulation confirmed that: The company should follow a written investment policy to be approved by the Board of Directors for asset allocation, taking into consideration all the risks faced by the company and the environment that it operates under, and the fact that the company should perform analysis on a regular basis, and also study the risks surrounding the company and the regions in which it does its business, as the company must take appropriate actions to manage such risks, and to maintain a minimum risk analysis as follows: market risk and credit risk, interest rate risk (the existence of an important role for the interest rate), and the risk of currency exchange rates (because the number of investment rates is linked with certain external markets), liquidity risks, operational risks, regulatory legal risks, re-insurance risks, as well as technical risks⁸¹.

6.2 Furthermore, Article 61 of the same Regulation stated that :

- a. The Company shall, when formulating its investment policy, take into consideration whether the maturity of its invested assets is in concurrence with its liabilities according to the policies issued. The Company shall provide the Agency with an investment policy that is inclusive of assets distribution. If such an investment policy was not approved of by the Agency, the Company would adhere to the investment standards in Table (1), provided that investments outside the Kingdom shall not exceed 20% of the total investment, in accordance with Article 59 (2).
- b. The Company shall take into consideration investment concentration risks. Concentration in an investment instrument shall not exceed 50% as one investment instrument is mentioned in table (1)⁸².

⁸¹ The Implementing Regulations. Saudi Arabian Monetary Agency.(SAMA). Art.60. supra footnote 10.

⁸² Ibid. Art.61.

Investment Type	Percentage for General Insurance	Percentage for Protection and Savings Insurance
1. Saudi authorised banks	20% minimum	10% maximum
2. Saudi Government bonds	20% minimum	10% maximum
3. Saudi Riyals denominated investment funds	10% minimum	15% maximum
4. Foreign currency denominated investment funds	10% minimum	10% maximum
5. Foreign government's bonds (Zone A).	5% minimum	5% maximum
6. Bonds issued by domestic companies.	5% minimum	5% maximum
7. Bonds issued by foreign companies.	5% minimum	5% maximum
8. Equities.	15% minimum	15% maximum
9. Real estate in Saudi Arabia.	0%	5% maximum
10. Loans secured by real estate mortgages.	0%	5% maximum
11. Loans secured by policies issued by the insurer.	0%	5% maximum
12. Other investments.	15% minimum	15% maximum

Table 4.1 The Implementing Regulations, Saudi Arabian Monetary Agency⁸³

Looking to the table however, it can be shown clearly that items number 1, 2, 5, 6 and 7 represent *riba*-based investment activities, because this generates a return with certain interest. Such items in general constitutes a maximum of 55% of the total investments in general insurance, and the first and second items represent at least 20% of the investment in insurance funds relate to so-called insurance protection and savings. Also, Items numbered 5, 6 and 7 constitutes 15% of the total investment of the same type of insurance as a maximum.

⁸³ Table 1. The Implementing Regulations. Saudi Arabian Monetary Agency.(SAMA). Supra footnote 10.

However, I would like to have an example which is the NCCI insurance company, as stated in the annual report for 2010 in explanatory notes related to the Financial Statements report as follows: (Investment Income: The income on the investment is calculated on the basis of actual revenues after taking into account the original net amount and the commission rate. Investment income for insurance operations is primarily realised in the form of the bonds/treasury bills issued by the Saudi Arabian Monetary Agency SAMA, domestic and foreign investment funds as well as investments in stock market⁸⁴).

In other words, an important aspect of investments and insurance funds has already been realised in the *riba*-based asset, which generates revenue bonds and treasury bills issued by SAMA.

There is no explanation of the situation regarding foreign funds, investment funds in stocks or in bonds, or both, and nor is there an explanation related to invested equity. This would be needed to clarify when a company's shares are engaged in permissible activity, and when its shares are engaged in prohibited activities.

Also interesting is that rates of illicit investments contained in the table for the general insurance are more than half.

⁸⁴ NCCI. The annual report for 2010. Supra footnote 38. p72

4.8 Conclusion

The purpose of this chapter to evaluate The Law on Supervision of Cooperative Insurance Companies and implementing regulations, also the rules of the Council of Cooperative Health Insurance regarding Implementing Regulations from the perspective of Islamic Sharia Law. Furthermore, this chapter covered;

- Insurance system and its consistency with the ruling regime in the Kingdom of Saudi Arabia.
- Characteristics of insurance policy in the Saudi regime.
- Legislative qualifications of the insurance company in collecting and investing contributions as well as payment of compensations.
- Legislative qualification of The Council of Cooperative Health Insurance (CCHI) in the Kingdom of Saudi Arabia.
- Surplus and its distribution.
- Investment of insurance funds.

However, the importance of this analysis is that Saudi Arabia confirms Islamic Sharia is the constitution of the Kingdom⁸⁵, so that logically all the rules applied, particularly in the case of Insurance law must comply with Islamic Sharia teaching, and the importance of the geographic and political position of Saudi Arabia. The presence of the two holy mosques increase Saudi Arabia's commitment to applying Islamic Sharia rules, as it is an example of applying Islamic Sharia among Muslim countries which have a majority of Muslims and are not applying Sharia rules in their constitutions.

I have criticised the Saudi insurance system from the perspective of Islamic Sharia Law from multiple perspectives and found the following

1. There is a mistake in the Legal constitution. Art. 1 in The Law on Supervision of Cooperative Insurance Companies stipulates that "Insurance in the Kingdom shall be undertaken through registered insurance companies operating in a cooperative manner as it is provided within the article establishment of the National Company for

⁸⁵ The Basic Law of Governance, Part one General Principles, Art.1.supra footnote 4.

Cooperative Insurance....”⁸⁶. However, this is a clear mistake in constitutional drafting. Many people interested in insurance are in a state of contradiction, about how the statute of the company is agreed upon by many researchers that are exercising an insurance business forbidden in some applications and provided by the system as an example that should be traced. Furthermore, the article added that: "in accordance with the principles of Islamic *Shari'a* "; such an addition is definitely in line with the regime in the country and is based upon the fact that the legislature, when drafting such a system has been aware that the National Company for Cooperative Insurance is to be criticised as far as Sharia scholars in the Kingdom are concerned.

2. The concept of insurance in Saudi Arabia is similar with the conventional insurance from the logic and the application.
3. The Law on Supervision of Cooperative Insurance Companies and The Rules of the Council of Cooperative Health Insurance and their implementing regulations do not reflect what is supposed to be in insurance in an Islamic concept based on donation; but they reflect the concept of conventional insurance based on a clear *Financial reimbursement contract (Muawadah)*.
4. All contracts between companies and insured persons are *financial reimbursement contract* and include a *Gharar* which makes this kind of contract is void.
5. The relationship between the company and the total insured may be qualified as a fee based agency for the management and regulation of insurance with the *deceit (Gharar)* in the wage, and thus the fee based agency contract is void. On the other hand, what is relevant to the investment of funds, the company is a joint trader (*mudarib*), so that each policyholder is an owner of the capital (*Rabuallmal*), whereas it is also an absolute trading point. It is still restricted in terms of time because the contract period is only one year, therefore, I can confirm that according to Islamic rules of *Mudarabah* this invented application is void as well, for two reasons, the first is ignorance in the amount of capital and the second is that the company would take a share of the surplus, which it is not entitled to take.
6. The distribution of the surplus does not reflect what should be an Islamic insurance concept. The shareholders and the Cooperative Health Insurance Council has a right which is not allowed to them, and involves depriving policyholders of their rights, as

⁸⁶ Supra. Foot note 6.

insurance companies get a part of the surplus, which is not an income achieved by the company, and that is exactly the case for the Council of Cooperative Health Insurance.

7. The existence of investment funds are not following Islamic Sharia rules as this makes the treatment with companies forbidden. An Islamic finance company must follow Islamic rules and all transactions to be considered as permissible *Halal* financial products even in terms of assets and investment⁸⁷. However, Article 61 of the Implementing Regulations confirms the allowance of all companies to invest in items representing *riba*-based investment activities, such as Foreign and Government Bonds, Saudi Riyals Denominated Investment Funds and Foreign Currency etc...
8. The legitimacy of cooperative insurance in Islamic thought does not necessarily mean the legitimacy of the applications of the Insurance companies.
9. The existence of an Islamic Sharia committee at insurance companies does not mean the legitimacy of the contracts or the financial treatments and transactions made by these companies.

Therefore, I do believe that the Saudi governor should set an independent central Sharia board⁸⁸ and gives all the required authorization for observation and redrafting of all articles being criticised in this thesis and by researchers and Islamic scholars.

Whereas, this chapter presented a critical analysis of Saudi Arabian insurance Law according to Islamic Sharia, the next chapter will be about the application of cooperative insurance in Saudi involving two cases study:

1. The National Company for Cooperative Insurance NCCI, which is the biggest one in Saudi insurance market.
2. Alrajhi Takaful Company.

⁸⁷ For, example trading in wine in Islamic Sharia is forbidden, thus, all wine company's shares are forbidden and not permissible for trading.

⁸⁸ I have mentioned this in my recommendations in the last chapter.

CHAPTER 5: APPLICATIONS OF ISLAMIC INSURANCE IN THE KINGDOM OF SAUDI ARABIA (USING NATIONAL COMPANY FOR COOPERATIVE INSURANCE (TAWUNIYA) AND AL RAJHI COMPANY FOR COOPERATIVE INSURANCE (AL RAJHI *TAKAFUL*) AS CASE STUDIES).

5.1 Introduction

The Kingdom of Saudi Arabia has witnessed a significant growth in population, with the number of inhabitants reaching 27,136,977 people, according to the preliminary results of the population census for the year 2010, compared to the 23.7 million inhabitants at the end of 2006.¹ This growth is accompanied by an increase in the demand for insurance services in general, and individual insurance services in particular, including both health and vehicle insurance. This will motivate insurance companies to not only expand, but to also increase their demands for reinsurance.

The Saudi insurance sector has thirty-two insurance companies trading in the stock market.² Among the most prominent is the Saudi National Company for Cooperative Insurance (*Tawuniya*), which highlights its importance as the largest and oldest company in the Saudi insurance industry. The Cooperative Insurance Companies Control System has been drafted based upon the statutes of the company.³ Al-Rajhi Cooperative Insurance (*Al-Rajhi Takaful*) is an important company, its strength lying in the Al-Rajhi financial institutions in Islamic finance, and is accompanied by the desire of shareholders to provide insurance products in line with Islamic laws. Certain applications of both companies for the concept of Islamic cooperative insurance, in terms of model and existing regulations in the company, as well as financial policies in place and the role of the Sharia Board, will be explored in the evaluation of this work, without infringement to the Islamic Sharia.

1 General Statistics & Information Authority, Ministry of Economy & Planning. Available online: <http://www.cdsi.gov.sa/>

2 Tadawul, available online: <http://www.tadawul.com.sa>

3 The *Implementing Regulations* of the Law on Supervision of Cooperative Insurance Companies, Art. 1, 2004, SAMA. Available online: <http://www.sama.gov.sa/sites/samaen/Insurance/Pages/LawsandRegulations.aspx>

5.2 The National Company for Cooperative Insurance (NCCI) (*Tawuniya*)

The National Company for Cooperative Insurance (NCCI) is a Saudi joint-stock company, founded in 1985 in accordance with Article 3 of the statute of the company: ‘the purpose of its establishment is to engage in practicing cooperative insurance and everything related to such actions inclusive of agencies, re-insurance and other works such that all is in accordance with Islamic Sharia.’⁴ The company is prepared to undertake any steps necessary in order to achieve its purpose, provided that they are in accordance with the provisions of Islamic law. The company started with a capital of 500 million riyals; the current capital amounts to SR 750 million in the year 2011. It is considered to be the parent company in the world of Saudi insurance, the largest of the insurance companies operating to have obtained a classification ‘A’ from Standards and Boards (S & P).⁵

In 2007, the company established the Sharia Board, as it has convened as much as sixty meetings since its foundation up to 2011, during which time it reviewed many collaborative documents and passed thirty-one new insurance products.⁶

5.2.1 APPLICABLE MODEL

The company applies the cooperative insurance model, as it provides the policy of Medical Malpractice Insurance and Public Liability: ‘the cooperative company in its capacity as director on behalf of the policyholders (the insured), to run the insurance operations as well as resulting rights and responsibilities in virtue of the statute of the company working on the principle of cooperative insurance. For this purpose, the company manages two separate accounts, namely the shareholders’ account and the Insurance Operations Account.’⁷ The company determines the net surplus of the policyholders’ account at the end of each financial year, after deducting the company’s fees and expenses in return for its management of the two insurance and investment operations. All or part of any net annual surplus resulting from

⁴ The Statute of the National Company for Cooperative Insurance. Art. 3. Edition 2011.

⁵ The Annual Report for NCCI, 2010. PP14- 15

⁶ The Regulation of Sharia Board of The National Company of Cooperative Insurance, 2007. Unpublished documents p. 1.

⁷ NCCI. Medical Malpractice Insurance and Public Liability insurance policy available online : <http://www.tawuniya.com.sa/Home/IndividualsInsurance/PropertyAndCasualty/MedicalMalpracticeInsuranceIndividual/tabid/450/Default.aspx>.

insurance operations is distributed among the policyholders.⁸ Therefore, the company creates two separate accounts: shareholders' account and insurance operations account.

Each account is charged with all relevant expenses and revenues. The company undertakes management in return for the fees, which are interpreted as general, administrative, sale, and marketing expenses. This is set under the costs and expenses in the insurance operations account; it is non-specific, but depends on the needs of the company's management of the operations account.⁹

As for investment in this model, the relationship between the company and the policyholders can be accommodated as a company of both shares and speculation at the same time. This is with respect to the investment of contributions accumulated by the company, which is religiously permissible, as both contracts are allowed separately and may therefore be combined into one contract. Albahooty (1051H) defined the *Anan* company as having two types,¹⁰ 'involving two or more funds, to be staffed by one provided that its profit is more'; 'The company, which applied this contract has two conditions: the first is *Anan* when considering that the money is paid by both parties; and the second is (*Mudarabah*) trading off whereby that work is from one party plus a profit on its money, as the work of one of the wealth of others, and part of profit'.¹¹ In other words, the money is provided by the company (the shareholders) and the policyholders, with the work being carried out by the company, i.e. the work is performed by shareholders for the benefit of all parties, in return for a certain percentage of profit, to be taken out of the profits of the insured after the distribution of profit on a certain initial amount.

⁸ Ibid.

⁹ Supra footnote 5 and 7.

¹⁰ In this regard, type one as an important addition, and there is no need to mention type two.

¹¹ Albahooty. M (H1051). *Kashaf Alqinaa*. Kitab- u-alshirkah, Dar Alaam Alkutub 1997 Lebanon, vol. 3, pp. 497.

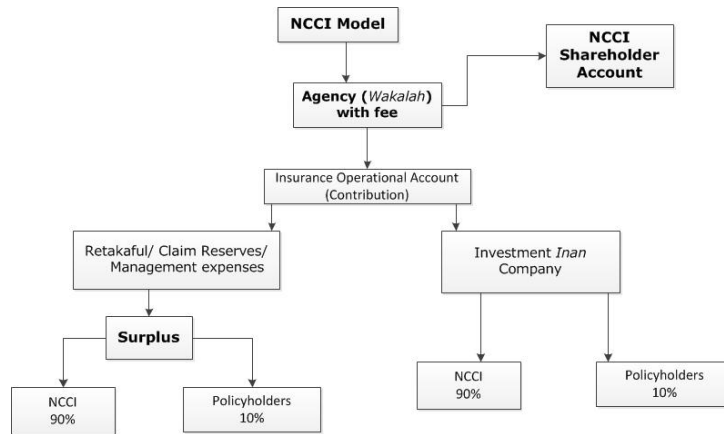


Figure 5.1: NCCI Model

5.2.2 DEFINITIONS

In its application of this model, the company adopts all definitions contained in the Implementing Regulations of the Cooperative Insurance Companies Control Law in Saudi Arabia:¹²

- **Company:** A public joint-stock company, conducting insurance and/or reinsurance activities.
- **Insurance:** Mechanism of contractually shifting the burdens of pure risks by pooling them.
- **Reinsurance:** Transfer of the insured’s risk from the insurer to the reinsurer, and to indemnify the insurer by the reinsurer for any payments made to the insured against damages or loss.
- **Insurer:** An insurance company that accepts insurance contracts directly from the insured.
- **Insured:** A person or juristic entity, who has entered into an insurance contract.

¹²The *Implementing Regulations* of the Law on Supervision of Cooperative Insurance Companies. Supra footnote 3, p. 1.

- **Insurance Policy:** Legal document/contract issued to the insured by the insurer, setting out the terms of the contract to indemnify the insured for loss and damages, as covered by the policy against a premium paid by the insured.
- **Contribution (Premium):** Amount offered by the insured to the insurer in exchange for the insurer's acceptance to indemnify the insured for loss/ or damages resulting directly from a covered risk.
- **Beneficiary:** A person or juristic entity to whom the benefit(s) is assigned as a result of a covered loss, under the terms of the insurance policy.

In view of the above definitions, and emphasising the words of reimbursement (*Muawadah*) therein, it is found that the contractual relationship between the policyholders and the company is a financial reimbursement relationship, as it does not appear in the texts of the company systems or its insurance policies or definitions. This denotes any reference to donation, meaning that the contractual relationship is based on the principle of indemnified security that commercial insurance is forbidden in Islamic Sharia. According to El-Qara Daghi,¹³ the passing of cooperative insurance is required to be in line with Islamic Sharia in the following ways:

1. The principle of donation, as the policyholders donate their premiums and returns in cooperation for the benefit of the cooperative insurance account. This is expressed in the cooperative company as the insurance operations account.
2. The formation of Islamic Sharia Board for fatwa and supervision, and all decisions to be binding under the management.
3. The company should act as an agent in the management of Islamic insurance business.
4. The company should establish a separate account for the money of the policyholders, as well as their returns.
5. The surplus of insurance belongs to the insurance policyholders.
6. As the company invests in the insurance funds account on the basis of trading (*Mudarabah*), there must be a provision in the contract of insurance to state the required percentage of profit realised for both parties.

¹³ El Qora Daghi.A (2006). Islamic Insurance. Dar Albashaer Alislamia. Burit, Lebanon., p. 172–73.

7. The company treaty is not obliged to any compensation in the case of deficit in the insurance operations account, and its money is not in opposition to the insurance liabilities.
8. The company should, through its own account, bear its own expenses and not add to the insurance operations account; profits on its money should also be paid back into it.

It is thus clear that the company in the applied model is not compliant with the teachings of Islamic Sharia, through a number of issues that will be explored in more detail.

5.2.3 INSURANCE ACCOUNT, OR INSURANCE PORTFOLIO

The insurance account, or portfolio, has been defined in the Implementing Regulation of the Cooperative Insurance Companies Control as a reciprocal exchange, which equates to an unincorporated association in which each insured insures the others within the association. Each participant in this pool is both an insurer and an insured. An attorney administers the exchange, including paying losses, investing premium, recruiting new members, underwriting new and renewal business, receiving premium, and exchanging reinsurance.¹⁴ The company has provided in Article 43, first/1, that ‘An account is allocated for contributions from the insured to the company in return for their insurance for risks specified in insurance policies issued by the company on their behalf’, and, in second/2, that ‘An account is allocated for compensations from the company to the insured in the event of risks covered by it’.¹⁵ It should be noted that the system does not make any reference to the intention to donate a payment, or whether this account is or is not a legally independent entity within the company.

5.2.4 COMPANY’S COMMITMENT TOWARDS OPERATIONS ACCOUNT, OR INSURANCE PORTFOLIO

¹⁴SAMA . *Implementing Regulation* (2005),supra footnote 3. p. 2.

¹⁵ The Statute of NCCI, Article 43, supra footnote 4, p. 14.

The company manages the business and undertakes to provide funding for the insurance portfolio (insurance operations account) when needed; the company therefore believes that it deserves its share of the surplus for its management, in addition to ensuring payment. Furthermore, its role in this instance is to act as a guarantor when there is a deficit in the operations account, but not to be a lender. However, on 20/01/2004, the company amended its memorandum of association to grant authority to the Board of Directors to determine the method by which surplus of insurance operations is deposited.¹⁶ The company statute has granted such permission to the Board of Directors, as stipulated in Article 43, first/5.¹⁷

A question arises here: Is it permissible to take a charge in return of warranty? Is this commitment in accordance with Islamic Sharia?

According to Al-Khathlan (2011), receiving a commission against the issuance of the letter of guarantee, i.e. the insurance policy, is not permissible, as taking a charge in return for guarantee is forbidden in Islamic Sharia. The concept of a guarantee is that it is a contract of charity and leniency, which is subsequently not allowed to receive compensation against security. As mentioned above, this is not acceptable because no return may be taken and there is no compensation for it. This has been adopted as per the four Islamic *Fiqh* Schools, i.e. *Hanafi*, *Maliki*, *Shafi'I*, and *Hanbali*.¹⁸ The Council of International Islamic *Fiqh* Academy of the Organisation of Islamic Conference explained the following in its second session during the conference in Jeddah, 22–28/12/1985: ‘Second: The guarantee is a donation intended to give charity, and scholars decided that it is not permissible to take a compensation on bail, because in the case the guarantor gives an amount of security similar to the loan with interest to the lender, that is legally forbidden as it is some sort of usury (*Riba*)’. It also decided the following:

¹⁶ The Annual report of NCCI, 2010, note no. 1, general, p. 68.

¹⁷ The Statute of NCCI, Article 43, supra footnote 4, p. 14.

¹⁸ Al-Khathlan. S. (2011). *The Fiqh of Contemporary Financial Transactions*, Mosque of Sheikh El Islam Ibn Tayemia, Riyadh. <http://www.taimiah.org/index.aspx?function=item&id=932&node=2448>

First: The letter of guarantee issuer should not take a certain payment in return for the warranty, usually taking into account the amount and duration of warranty, whether with or without a coverage.

Second: Administrative expenses for the issuance of the letter of guarantee of its both types are permissible religiously, taking into account not to increase the same pay and, in case of cover whether whole or in part, it may be taken into account in estimating the expenses for issuing the letter of guarantee what it may be required to perform the actual task for such cover.¹⁹

5.2.5 COMMITMENT TO THE APPLICATION OF ISLAMIC LAW

The company confirms its commitment to the provisions of Islamic Sharia in all its works and activities, in accordance with Article 3 of the company statute.²⁰ This is carried out under the supervision of a Sharia Board, established on 25/2/2007, and composed of selected specialists in Sharia law and jurisprudence of transactions, who have an interest in insurance business and investment. The Board of Directors is appointed, as well as its members, in order to adopt the regulations. The Sharia Board attempts to set out the steps that need to be taken by the company, as a means of achieving its commitment to a legitimate approach to their transactions; the decisions are binding to the company.²¹

5.2.6 POWERS AND DUTIES OF THE SHARIA BOARD (TAWUNIYA)

Article 5 of the regulation of the Sharia Board emphasises the powers of the body,²² as it states:

¹⁹ Resolution of Islamic *Fiqh* Organisation, no. 12 (12/2), regarding letter of guarantee, 1985.

<http://www.shareah.com/index.php?records/view/action/view/id/4038>

²⁰ The Statute of NCCI, Article 3–2, supra footnote 4, p. 2.

²¹ The Regulation of Sharia Board of NCCI, 2007. Unpublished documents. Article 2/A, supra footnote 6, p. 1.

²² The Regulation of Sharia Board of NCCI (2007), supra footnote 6.

- A. 'All financial transactions relating to the company's insurance operations and investment in favor of policyholders are subject to account the approval and control of Sharia Board, as the decisions of the body should be binding to the company.'
- B. It performs the following tasks:
- 1- Give the final credit of Sharia-based auditing of the company's system and regulations relating to its internal processes, as regards both insurance operations and investment in favor of policyholders.
 - 2- Provide a statement of Sharia ruling in all transactions of the company insurance operations and investment related to the policyholders' account and subsequent contracts, agreements, forms, procedures manuals, etc., and also disclose the required notes on, and ways to, solve and overcome any problems in making proper Sharia decisions in this regard.
 - 3- Provide a statement of Sharia ruling on what is offered to the board, with reference to formulas and new products related to the insurance operations or investment of the policyholders' account, and to issue decisions and *Fatwas* accordingly.
 - 4- Verification of the company's commitment, in all its dealings on the processes of insurance and investment of policyholders' account, being in line with decisions and *Fatwas* of the board, and, making sure of correct implementation, the board may assign one of its members, or one of the Sharia controllers, to conduct periodic visits for the purpose monitoring or assigning a specific control task.
 - 5- Providing advice and guidance in referrals by the company to the board, including all legitimate queries.
 - 6- Receiving comments and statements regarding the Sharia aspects of all transactions of the company, internally or externally, and responding to them as such.
 - 7- Assigning one or more observers of Sharia to perform any duties assigned to him by the board, including audit and control tasks. The board is entitled to assign one such controller in attending its meetings, but he shall not have the right to vote. The board may choose a third party to carry out Sharia observation, to be contracted by the company's management.

- 8- Taking decisions on Sharia performance reports, which are sent to the board from auditing and regulation institutions that are mandated to do so.
- 9- Prepare reports at the end of each financial year, including a summary of the decisions and opinions issued about the company transactions. and disclosing the company's commitment during the year, including the contents according to the decisions of the scope of work and observations that may be given in this regard.
- 10- Issuing a leaflet of advisory opinions of the Sharia Board and its research.

It should be noted that the Sharia Board has broad powers, in order to maintain the commitment of the company to all Sharia controls in its work and decision-making, which are binding to the company, but it is still subject to the authority of the Board of Directors administratively, as Article 2/B of the Regulation of the Sharia Board provides for 'The constitution of the Sharia Board and choosing of members is by the Board of Directors and the Sharia Board shall be independent in its field of specialization for all departments of the company'.²³

On the other hand, the disadvantages of this situation for the Sharia Board members will reduce their scope for independence, and therefore all members should be nominated by policyholders as a means of ensuring that all decisions are Sharia-dependent.

5.2.7 SURPLUS

The company follows the Implementing Regulations of the Cooperative Insurance Companies Control System on the equivalence of the surplus, as per article 70/2/ C, D, and E, as the company should take into consideration the following when preparing a list of insurance operations:

²³Ibid.

C) At the end of each year, the total surplus representing the difference between (a) and (b), less any marketing and administrative expenses, necessary technical provisions, and other general expenses related to the operation of insurance, shall be specified.

D) The company's net surplus shall be determined by adding or subtracting the investment return of the policyholder's invested funds, and subtracting the general expenses relating to the policyholder's portion of the investment activity.

E) 10% of the net surplus shall be distributed to the policyholders directly, or in the form of a reduction in premiums for the following year. The remaining 90% of the net surplus shall be transferred to the shareholders' income statement.²⁴

As such, it is emphasised in Article 43/5/A of the Statute of the Company that shareholders deserve their share of surplus, as a result of exposing them to their right of insurance against risk, which has been defined under the Insurance Companies Control Article (70/2/e), with 90% going to shareholders and 10% to policyholders. Thus, the company follows the system of the Saudi Arabian Monetary Agency (SAMA), which is specifically contrary to Islamic Sharia law, as the insurance portfolio belongs to the policyholders, confirmed by a number of scholars of Sharia law, and should not be taken from them unless with their consent.

A question arises here, as to whether the deducted 90% of the surplus that the company claims in return for exposing the shareholders' equity to insurance risks, is a fair value for policyholders?

When considering the company's financial policies, a safe back-up policy has been found to be necessary, based on several types of reserves, such as:

1. Capital reserve: as much as 500 million riyals.

²⁴ SAMA. *Implementing Regulation*, 2005, supra footnote 3, p. 23.

2. Statutory reserve of the company: in accordance with Article 44/2 of the Statute of the Company, 20% of the net value of the profit is withheld as a regular reserve; such withholding should be canceled if the total has reached 100% of total paid capital.²⁵
3. Technical reserves: to be deducted from the insurance operations account, according to the balance sheet in 2010 and under the Liabilities and Surplus of Insurance Operations,²⁶ which includes:
 - I. Reserve *Takaful* operations.
 - II. Reserve discontinuing operations.
 - III. Claims under settlement.
 - IV. Unearned insurance commissions.

In the case of a deficit in the accounts of insurance (insurance portfolio), the company shall withdraw technical reserves first if the coverage is accomplished, otherwise the Statutory Reserve and Capital shall be transferred in accordance with this arrangement.

Accordingly, in reference to the balance sheet, it is found that, in 2010, the reserve account insurance operations reached more than 3 billion 9 hundred million (3900,000,000) SAR, while the total capital reserve and statutory reserve reached one billion. This means that reserves of insurance operations belonging to the policyholders reached more than the capital reserve and statutory reserve combined, which both belong to shareholders approximately four times over. Does it seem reasonable to deduct 90% of the surplus for the possibility of their equity being at risk, which is covered by Insurance Operations Account of more than four times of the total capital reserve and statutory reserve?

This shows clearly that the ratio is exaggerated and unfair to the policyholders, taking money out against a possibility. Thus, it is a deceit, which is forbidden in Islamic Sharia. However, fixing such a high percentage, as much as 90%, confirms that the objective is to capture the surplus, as it is essentially from the perspective of the insurance industry, due to the

²⁵ The Statute of NCCI, article 43, supra footnote 4, p. 16.

²⁶ The Annual Report of NCCI, 2010, supra footnote 17, P. 57.

commercial nature of the insurance company. Therefore, the end result of this legislation is to make insurance more profitable for shareholders, thereby strengthening the insurance market, regardless of the rights of policyholders and Sharia law.

5.2.8 INVESTMENT

Article 7 of the Statute of the Company states that ‘The Company invests in money accumulated from the insured and shareholders in the company in accordance with the rules established by the Board of Directors’.²⁷

Therefore, the company’s 2010 annual report on investment is divided into two parts:²⁸

1. The insurance operations account invested in:
 - a. Mutual funds or shares (domestic and external).
 - b. Companies in which it owns shares, namely:
 - i. The Cooperative Company for Real Estate Investment.
 - ii. Nagm for Insurance Services.
2. The shareholders’ account invested in:
 - a. Mutual funds or shares (domestic and external).
 - b. Companies in which it owns shares, namely:
 - i. United Insurance Company.
 - ii. Waseel Company for providing application services.

Whereas Article 3 of the Statute of the Company explains that ‘the company has the right to carry out its purposes whether in the field of insurance or investing its funds, provided that it is in accordance with the provisions of Islamic Sharia, so the company can move the immovable or cash funds and sell, exchange or lease them, directly or through companies to be established, bought by it or jointly with third parties.’ The company may have an interest in, or shares with, bodies engaged in activities similar to its own, cooperating with the company in order to achieve its purpose, or to incorporate or buy them as the company carries out the acts

²⁷ The Statute of NCCI, Article 43, supra footnote 4, p. 3.

²⁸ The Annual Report of NCCI, 2010, supra footnote 17, p. 79–82.

mentioned in the article, both within or outside the Kingdom, and in accordance with the provisions of Islamic Sharia.²⁹ The company is found to be investing in funds, stocks, and bonds, domestic and foreign affairs. As a number of Sharia scholars denied the bond, because it is seen as some form of usury, the company may have violated some of its investments through this article of the Statute of the Company; furthermore, the company contravened the Cooperative Insurance Companies Control Law, Article 1, which stipulates the application of cooperative insurance in a manner not contradictory to Islamic Sharia.³⁰

5.2.9 OVERALL OPINION ON THE APPLICATIONS OF THE COOPERATIVE COMPANY FOR ISLAMIC COOPERATIVE INSURANCE, AND ITS COMPLIANCE WITH ISLAMIC SHARIA

The NCCI confirms that it has applied the concept of cooperative insurance and that, so as to achieve this, it had to separate the shareholders' account from the policyholders' account (insurance operations account), but the contractual relationship in the company's model was not clear on several aspects:

- Realisation of Paid Agency in the Relationship Between the Company and Policyholders

The NCCI '*Tawuniya*' considers itself to be an agent for the policyholders in the management of the insurance portfolio (insurance operations account) and receives a certain amount of pay in return. *Tawuniya* adopts a particular accounting method, charging the costs and expenses in relation to its performance in its role as agent to the insurance operations of its personnel, costs of underwriting and insurance policies, and expenses of excess loss, among others. It adds all revenues, including investment income, to the account of the insurance operations, which is acceptable both from technical and accounting perspectives, but does not refer explicitly to the fees of agency; this is supposed to be a specific value, in order to match the contract in accordance with the teachings of Islamic Sharia. It does not refer to its fees of

²⁹ The Statute of NCCI, article 3, supra footnote 4, p. 1.

³⁰ SAMA, 2004, *Cooperative Insurance Companies Control Law*. Available online: http://www.sama.gov.sa/sites/samaen/Insurance/InsuranceLib/4600_C_InsuraLaw_En_2005_08_17_V1.pdf

investment in policyholders' funds, either, whether the contract is *Mudarabah* or *Anan*, which should be determined by the company, in terms of the proportion of profit from investment, and be brought to the shareholders' account as investment dividends. This also takes into account the value of the agency fees, as they are supposed to cover all expenses, in addition to the profit that is supposed to be earned by the company as a paid agent. However, what actually happens, is that the mixing of funds, which confirms that the company considers all its accounts as a single entity, resembles the work of commercial insurance.

The NCCI *Tawuniya* seeks to earn profits from net surplus by first deducting 90% as per article 70/2/ E and adding this to the shareholders' accounts as a net profit; this leaves a residue of 10% for the policyholders, so there is no clear distinction between NCCI *Tawuniya* in its application of cooperative insurance and conventional commercial insurance. The only difference is in its separation of accounts (the shareholders' accounts differs from those of the policyholders). However, traditional insurance applications depend on a single account being considered the company's legal entity, and, in the end, surplus is considered as net profit. This is different in *Takaful* and cooperative insurance, as the company then acts as a paid agent with its own entity and account, whereas the policyholders' account is an independent entity with its own account.

- The Relationship Between the Policyholders

The financial reimbursement contract *Muawadah* is one of the most prominent features of conventional insurance contracts, as it is considered to be a contract in which deceit is present. Therefore, Muslim scholars turn contracts of insurance from *Muawadah* into donation contracts, which intend for the subscriber to pay insurance premiums on a voluntary basis, as a means of calculating the insurance operations, and thus have the right to benefit from such donations.³¹ This is not on the basis of a trade-off, however, as money to be paid as a result is compensation money, because the contracts of donation are without deceit, and upon looking at the documentation of *Tawuniya* and its systems, all the definitions adopted by the company, as per the definition of insurance policy and premium subscription, refer to the *Muawadah*, not

³¹ This topic was explored in the preceding chapter 3, p 27- 45.

to donations. Consequently, contracts emerging from the relationship between the policyholders are contracts of deceit, which constitutes a violation to Islamic Sharia.

- Distribution of the Company's Surplus

In the distribution of surplus, the company relies on the Cooperative Insurance Companies Control Law (SAMA), which was adopted based on the Statutes of the National Company for Cooperative Insurance (*Tawuniya*). The company stresses that the maturity of the surplus, or at least part of it, is against the management of the operations account, in addition to the guarantee, with deficit for the Insurance Operational Account. In Islamic Sharia, this warranty forms a charity contract and, therefore, accrual of such surplus to the company against security is contrary to Islamic Sharia.

- Investment

Pursuant to the provisions of the Statute of the Company, which were asserted in the SAMA regulations, the company confirms its commitment to the teachings of Islamic Sharia, with regard to investment. However, in the annual report of 2010, investments in domestic and foreign funds and shares, both in the shareholders' account and policyholders' account, and this type of investment is contrary to the Islamic Sharia.

- Sharia Board and the Application of Islamic Sharia

Based on the company's commitment to the provisions of Islamic Sharia, the Sharia Board was established in 2007, creating a team of elite specialists in Sharia and Islamic finance. During four years, the board held a number of meetings, reviewing cooperative insurance policies and approving many products, as well as reviewing and approving the investment and private savings system for the personnel of the company.³²

There is a degree of irony in these facts, however. On a disciplinary level, the powers and functions of the board are confined to the works and activities of insurance operations

³² Ibid.

account,³³ which would be out of the control and power of financial practices and investment, which lies with shareholders' account, as well as at an administrative level.

With regard to the review of policies, there remains a level of deceit as a result of financial reimbursement contracts in the insurance policies, as well as contractual relations in the company. On which aspect of Islamic Sharia has this been legitimately adopted? Did the Sharia Board notice the deceit in the insurance policies? Or did the board authorise traditional commercial insurance, which is forbidden by a number of scholars and jurisprudential academies, as it opposes the approved system of Cooperative Insurance Companies Control, 2004?

From the investment aspect, the company still comes under criticism in some ways by those interested in this field, as the insurance company invests in financial products that are illicit, such as international funds and bonds. So what has the Sharia Board been doing during the past four years in the evaluation of legal drafting for the company's investments?

From the above, it is already evident that the Sharia Board requires greater effort in the development of its structure and management performance, and to enhance the regulatory activity for evaluating activities, acts, documents, and investments of the National Cooperative Insurance Company (NCCI).

³³ The Regulation of Sharia Board of NCCI, 2007, article 2/A, supra footnote 6.

5.3 Al-Rajhi Company for Cooperative Insurance (Takaful Al-Rajhi)

The Al-Rajhi Company for Cooperative Insurance is a Saudi joint-stock company, founded on 1/6/2009; its licensing was approved by Royal Decree No. M/6, dated 2/6/1424 AH. The capital of the company is 2 hundred million Saudi riyals (200,000,000).³⁴ The company's vision is to be one of the leading companies in the provision of insurance services to cooperative public service customers seeking insurance products that are compliant with Islamic Sharia.³⁵

5.3.1 APPLICABLE FORM

The company depends its management on the hyper model, based upon a paid agency contract in the management of portfolio and *Mudarabah* for investment. The contractual relationship between the participants is founded on donation, as in paragraph two of the bases and principles upon which the company operates. The subscriber (policyholder) consolidates with the rest of participants (policyholders), as they donate their subscriptions in the portfolio of *Takaful*, in order to cover the risks that may fall to any of them in accordance with the principles of *Takaful*, as prescribed by the Sharia Board of the company.³⁶

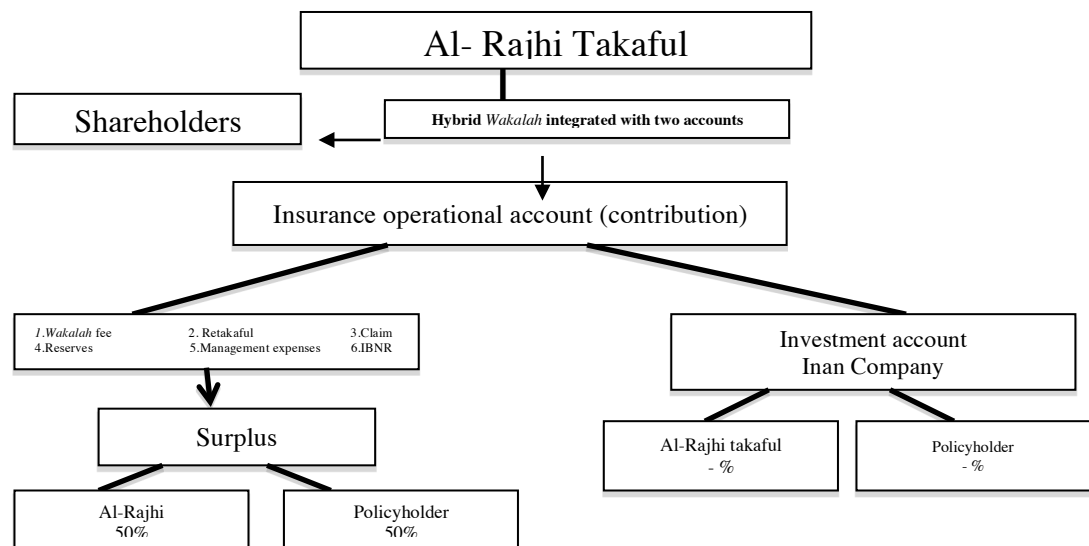


Figure 5.2: Al- Rajhi Takaful Model

³⁴ The statute of Al Rajhi Company for Cooperative Insurance. Art 7.

³⁵ Alrajhi Takaful. *Company Profile*. (2011). P17

³⁶ Alrajhi Takaful. *Car Insurance Policy 2011*. The Bases and Principles upon which the Alrajhi Takaful Company operates Takaful Fund. Paragraph (1/2).

5.3.2 DEFINITIONS

- **Insurance Policy:** In the company prospectus, the insurance policy is defined as ‘a contract in which a participant enters with the rest of the participants to disperse the risks that fall to any of them using a way of donation’.³⁷ In the terms and conditions of the insurance policies, the company states that the policy evidences what is specified by the schedule or policy, or any attached annexes or supplements.³⁸
- **Premium (subscription):** This is the amount payable by the policyholder to the *Takaful* fund during the period of insurance. In this respect, whereas the policy does not provide explicitly for donating the premium, it does confirm in its introduction that such premium must be paid for donation.³⁹
- **Insurer:** This is the *Takaful* portfolio that is managed by the insurance company, accepting insurance directly from the insured on its behalf.⁴⁰
- **Insured:** The person or legal entity in a portfolio of *Takaful*, looking for coverage upon the occurrence of risk under the insurance policy.⁴¹
- **Insurance Portfolio (*Takaful* portfolio):** A fund to cumulate the contributions of policyholders (subscribers) to donate to, and so as pay for, coverage. This portfolio has independent legal entity status separate to the company, and is run by the company on behalf of its policyholders (subscribers) on the basis of a paid agency model.⁴²
- **Status of the Company’s Portfolio of *Takaful*:** According to the fundamentals and principles governing the exercise of company’s cooperative insurance operations, as approved by the Sharia Board, claims of coverage should be directed initially to the portfolio of *Takaful* as the insurer party, so losses that may result from such claims are attributed to the portfolio. Whereas the legal statement in the company’s system links such losses with the financial situation and the impact on its financial results, for this purpose, and to assess the financial situation of the company in the future, any

³⁷ Al-Rajhi *Takaful*, the prospectus of the company, 2008.

³⁸ Al-Rajhi *Takaful*, ‘Car comprehensive insurance policy’, 2011. Al-Rajhi *Takaful*, ‘Car third party insurance policy’, 2011. Al-Rajhi *Takaful*, ‘Insurance policy for commercial vehicle’, 2011.

³⁹ *Ibid*, definitions, paragraph 2/1.

⁴⁰ Al-Rajhi *Takaful*, the prospectus of the company, 2008, *supra* footnote 42, definitions, p. 25.

⁴¹ *Ibid*, p. 25.

⁴² *Ibid*, p. 24.

connection with loss of the portfolio or debts related to it will consider the company as lender or loser guarantor of portfolio *Takaful*.⁴³

5.3.3 COMMITMENT TO THE APPLICATION OF ISLAMIC SHARIA LAW

The company is committed to abide by the provisions of Islamic Sharia in all aspects, under the supervision of the Sharia Board, who are experienced in financial transactions. The general assembly appoints the Sharia Board members and adopts all its regulations. The Sharia Board sets out the steps to be taken by the company in its efforts to commit to a legitimate approach in its dealings and decisions, which are binding for the company. It is also interested in assessing the legitimate performances of all the company's activities through a special department. At the end of the year, the Sharia Board issues a legitimate control statement in the general assembly's meeting.⁴⁴

5.3.3.1 The Mechanism for Achieving Legitimate Compliance

The Al-Rajhi Company for Cooperative Insurance is obliged to achieve the requirements of Sharia in all its workings, in accordance with the vision of the Sharia Board thereof. The Sharia Board considers every insurance product upon completion of its technical structure, studying the legal and legitimate aspects. The Sharia Board also receives reinsurance agreements and investment contracts that the company intends to conclude.

A Sharia Board has a legitimate department that is a preparatory and regulatory control system, called the Sharia Auditing Department. It prepares issues to be submitted to, and briefed by, the board.

⁴³ Ibid, p. 26.

⁴⁴ Ibid, p. 15.

5.3.3.2 Functions of the Sharia Auditing Department

The Sharia Auditing Department carries out the following tasks:⁴⁵

1. Verify any activity, product, service, or contract in progress within the company, passed by the Sharia Board.
2. Review forms, contracts, policies, and contracts before use.
3. Make sure that the company, in all its branches and internal and external departments, is committed to implementing the decisions of the Sharia Board.
4. Validate the company's commitment to abide by Sharia Board legitimate policies.
5. Implement field control visits to departments of the company and its branches on a regular basis.
6. Prepare a periodic report containing the results of field control of activities and processes; identify notes related to Sharia aspects, with respect to the areas of company.
7. Raise awareness of the Islamic economy in general and Islamic cooperative insurance systems, in particular within the company.

It is notable that Sharia Board in Al-Rajhi *Takaful* is vested with broad powers, so as to maintain the company's system in accordance with Sharia requirements in all its dealings. The members therein are appointed by the general assembly and do not report to the Board of Directors, which gives a greater level of independence to its decisions.

The Al-Rajhi Company for Cooperative Insurance aspires to have all its products comply with Islamic Sharia, in view of the decision taken by the Sharia Board. The company has two main categories of insurance services. The first pertains to general services, such as insurance on properties, against liability, and maritime insurance. The second contains new insurance services that are allocated to certain categories, such as home insurance, travel insurance, and

⁴⁵ Al-Rajhi *Takaful*, Sharia Auditing Department, 'Functions of the Sharia Auditing Department', unpublished document.

accident insurance. In order to select and maintain a superior insurance portfolio, the company aims to take prudent steps in the fields of vehicle and medical insurance.⁴⁶

5.3.4 SURPLUS

The company follows the Implementing Regulations of SAMA, Article 70/2/e, thus providing for Article 43/5 on the distribution of net surplus, which distributes 10% to the insured directly, reducing premiums for the following year, and deposits 90% into the shareholders' account.⁴⁷

As previously stated in the Islamic insurance model, the surplus belongs to the policyholders, who are entitled to grant a part thereof to the company as a reward for good performance. Therefore, the company's Sharia Board tries to abide by such principles. The breach in the Implementing Regulations of SAMA, Article 70/2/e, regarding how the surplus distribution was treated, prompted the Sharia Board to decide, as per decree no. 3 on 26/7/2009, upon the following:

1. The insurance surplus is due to insurance portfolio, as it is representative of the surplus of its funds; the company may be granted a part of surplus as a fixed grant according to the *Jua'la*⁴⁸ contract, based upon the following reasons:
 - 1.1 Compared to the admissibility of agreement that a client gives his agent, the surplus of money is paid to him upon performance of his work.
 - 1.2 Due to the company's efforts to achieve the surplus.

2. It should take into account the following conditions:
 - 2.1 The existence of certain work done by the company as indicated in 1.2.

⁴⁶ Al-Rajhi *Takaful*, the prospectus of the company, 2008, supra footnote 42.

⁴⁷ The Statute of Al-Rajhi Company for Cooperative Insurance, article 43, insurance operations account/5.

⁴⁸ *Jua'la* is an Arabic term, 'an agreement where one party commits to pay a determined sum to the second party when achieve a specific result at specific or unspecific time'. See Accounting and Auditing Organisation for Islamic Financial Institutions Standars (AAOIFI), available online: <http://www.aoifi.com/>

2.2 This should be under the explicit condition of a defined percentage in the contract, concluded by participants.⁴⁹

In principle no. 6 of the fundamentals and principles of the company's insurance policies it is found that:

Distributable surplus of *Takaful* portfolio = (total contributions + profits of investment in *Takaful* portfolio + re-*Takaful* commissions + amount refunded from dangers that have been covered previously) - (agency fees + amount of re-*Takaful* + claims + share of speculator [company] out of investment + debts + reserves variance).

Therefore, the company will act as it deems fit in the interests of the portfolio, within the limits of the following options:

A- Reduction of contributions over the coming years.

B- Distribution of surplus, in full or in part (at least 10%), annually to all participants in proportion to their participation, regardless of who has been covered for damage that has occurred, or not covered due to no misfortune.⁵⁰

To this end, although the company has apparently committed itself to implementing regulation of insurance companies, it recognises the entitlement of the insured for more than 10%, and refers to its belief that the surplus should be awarded to policyholders, not shareholders. However, the provisions of SAMA force the company to such formulation, and the Sharia Board emphasises that the surplus of insurance is due to the insurance portfolio. As it is a surplus of its funds, the company may grant a part of the surplus as a royalty, based upon the aforementioned conditions.

⁴⁹ Decision no. 3 on 26/07/2009, the Shariah Board of Al-Rajhi Company for Cooperative Insurance, unpublished document.

⁵⁰ Al-Rajhi *Takaful* . Principles and bases to be stated in all insurance policies, no. 60.

5.3.5 OVERALL OPINION ON THE APPLICATIONS OF THE AL-RAJHI COMPANY FOR ISLAMIC COOPERATIVE INSURANCE, AND ITS COMPLIANCE WITH ISLAMIC SHARIA

The Al-Rajhi *Takaful* Company for Cooperative Insurance confirms that it has applied the concept of Islamic cooperative insurance. So as to achieve this, it had to separate the shareholders' account from policyholders' account, but the contractual relationship of the company's model remains clear from several aspects:

Realisation of the Paid Agency Concept in the Relationship Between the Company and Policyholders

The company considers itself to be an agent for the policyholders in the management of insurance portfolio, and receives a certain amount of pay in return (as an agency fees), which is then added to the policyholders' account in the form of expenses. A particular accounting method is adopted, however, that charges the costs and performance-related expenses to the insurance operations account of its personnel, including the cost of underwriting and insurance policies, and the expenses of excess loss.⁵¹ It is considered an acceptable technical accounting procedure, which defines the agency fee. In terms of investment, on the other hand, there is no accumulated surplus to be invested because the company is new.

Al-Rajhi *Takaful* seeks to accrue profit through net surplus and agency fees, which demonstrates a clear difference the application of cooperative insurance in contrast to conventional commercial insurance, as it represents the separating of accounts (the shareholders' account differs from that of the policyholders) and the clearing of agency fees. Conventional insurance applications depend on a single account however, as the company is a single legal entity, and any surplus belonging to it is ultimately considered net profit. Therefore this is the distinguishing feature between *Takaful* and cooperative insurance, as the company acts as a paid agent and has its own entity and account, whereas the policyholders' account is an independent entity with its own account.

⁵¹Al-Rajhi Company for Cooperative Insurance, review report (2011) , p. 5.

The Relationship Between the Policyholders

The reimbursement contract (*Muawadah*) is one of the most prominent features of conventional insurance contracts, as it is considered to be one in which deceit (*Gharar*) takes place. Therefore, Muslim scholars turn their intention to contracts of insurance, from reimbursement contracts to donation contracts, as the subscriber's intention is to pay their insurance premiums to the insurance operations account on a donation basis, and to have the right to benefit from such donations.⁵² This is not on the basis of reimbursement, as money is to be paid as resultant compensation so that the contracts of donation are without deceit. Considering the documentation of Al-Rajhi *Takaful* and its systems, all the definitions adopted by the company are as per the definition of insurance policy and premium with reference to donation, and contracts emerging from the relationship between the policyholders are subsequently contracts of donation, with no deceit, and are thus compliant with Islamic Sharia.

Distribution of the Company's Surplus

For the distribution of surplus, the company adopted the law of Supervision of Cooperative Insurance Companies. They stress that the deducting of the surplus, or part of it, is against the management of the operations account and does not guarantee the account in the case of deficit. It has already been noted that this guarantee in Islamic Sharia is one of a charity contract, and therefore cannot be compensated. SAMA, in its formulation and division of surplus at 90% for shareholders and 10% for policyholders, consequently forced the company to insert such ratios into its policies. This maturity has been welcomed by the Sharia Board, which stressed that an insurance surplus is due to the insurance portfolio, as it represents the surplus of its premiums, and the company may thus grant an insurance surplus based upon *Jua'la*. Furthermore, the share of the surplus belonging to the company is not in return for warranty, but as a reward for good performance, so that the company grants a minimum of 10% for the policyholders and receives no more than 50% out of the surplus itself, which does not violate Islamic Sharia.⁵³

⁵² This topic was explained in the preceding chapter 3, p 27-45.

⁵³ Al-Rajhi *Takaful*, Sharia Auditing Department, supra footnote 50.

Investment

Investment is pursuant to the provisions of the Statute of the Company, as asserted by the SAMA regulations. Therefore, the company is able to confirm its commitment to the teachings of Islamic Sharia with regard to investment, but as it was only founded in 2009, there is less opportunity for surplus to be invested, except for some simple investments in the domestic stock market. This is in favor of the shareholders, as the Sharia Board has allowed to the company to make such investments.

Sharia Board and the Application of Islamic Sharia

To support the company's commitment to the provisions of Islamic Sharia in all its acts and activities, the Sharia Board was established in 2009, created by an elite of specialists in Sharia and Islamic finance. It plays a critical role in legislation and control. The company has sent a number of officials abroad, in order to receive the benefit of international experiments in Islamic insurance applications, to countries such as Malaysia and Sudan. The officials have had good experiences, but continue to require more, including on an administrative level, so the board has a special department and a number of efficient individuals who coordinate tasks such as reviewing and developing policies, as well as following up company activities and auditing performance in compliance with board decisions. It has a clear connection to the company's other departments, so as to bring about products that are compliant with the standards of Islamic Sharia and Islamic insurance.⁵⁴

As stated above, it is clear that the board, despite its distinguished role, needs to put in greater effort in the development of its administrative structure, and for officials to assume their duties and enhance their controlling activities, as a means of assessing the activities, works, policies, and investments of Al-Rajhi *Takaful*.

⁵⁴ Ibid.

5.4 Recommendations

1. Article 1 of the law on Supervision of Cooperative Insurance Companies stresses that insurance companies should work in accordance with Islamic Sharia, but there is no indication that firms should be accountable in case of violation, or that there are fair penalties for such violation.
2. Considering the policyholders' account, experts on Islamic finance as an independent legal entity face various challenges, such as:
 - a. Policyholders do not know each other.
 - b. Their interests are different.
 - c. There is no authority or committee to represent them in the company.

Islamic financial experts therefore assumed that the policyholders should be an independent entity, with the right to determine what is given to the company from the surplus as a reward for good performance, or from a share of investment profit, which forms part of a default model that is far from reality. Thus, the recommendation for the existence of a body to represent policyholders is important, in order to defend their rights, and establish investment policies and administrative operations for their account or portfolio of *Takaful*. This body should direct the Board of Directors of the company to also direct the policyholders' account in following such policies, and to be properly accountable for performance.

5.5 Conclusion

The study aimed to evaluate the law on Supervision of Cooperative Insurance Companies, as well as the Council of Cooperative Health Insurance, their implementing regulations and the applications of the National Company of Cooperative Insurance NCCI, as well as Al-Rajhi *Takaful*; all in compliance with Islamic Sharia. The study included policies designed according to the Saudi Arabian Monetary Agency, or SAMA. Evaluation has been carried out on theoretical and practical insurance, in addition to practical application of the model and eventually exploring the objectives of cooperative insurance, surplus distribution, and investment in insurance funds. The study revealed the following:

1. The Saudi insurance law is similar to conventional insurance thought, in terms of the purpose of the insurance, and in both constructive theory and practice of insurance, even that which has been asserted in the law to be in accordance with Islamic Sharia.
2. The law on Supervision of Cooperative Insurance Companies and its implementing regulations, and the rule of the Cooperative Health Insurance Council and *its* implementing regulations, does not reflect presumed insurance, as per Islamic thought, in terms of donations. It reflects the concept of insurance in terms of conventional thought, which is based upon reimbursement, and the possibilities and obligations of both parties.
3. The insurance policies of the National Company of Cooperative Insurance NCCI do not reflect the requirement of cooperative insurance in Islamic thought in terms of donations, but rather the concept of insurance in terms of conventional thought on reimbursement, as the items in policies in many provisions provide explicit evidence towards the will for reimbursement.
4. NCCI insurance contracts, in view of the relationship of a particular policyholder to the rest of the policyholders, represents financial reimbursement within the body, which is an obscene deceit and thus nullified as per Islamic Sharia. Al-Rajhi *Takaful*, on the other hand, succeeded in applying the donation concept to its contracts and removing the deceit therein, making them in compliance with Islamic Sharia.
5. The distribution of surplus at NCCI does not reflect what is necessary in view of Islamic thought, whereas Al-Rajhi *Takaful* did succeed in correcting the fault in the implementing regulation, Article 70/2/c, d, and e, and is in line with Islamic Sharia.
6. The presence of investment funds in NCCI, which are in violation of Islamic Sharia, affects the permissibility of dealing with such companies.
7. The legitimacy of cooperative insurance, as based upon the proven assumption that it does not necessarily equate to the legitimacy of existing applications, is called cooperative insurance.
8. The existence of Sharia Board bodies in a number of insurance companies does not necessarily guarantee the legitimacy of contracts and transactions of such companies. Therefore, Sharia Board bodies must be independent, so as not to be subject to a conflict of interests.

9. Contemporary insurance companies reflect the school of thought applied by insurance companies for the Sharia Board, which is shown through its approval of contracts and transactions of such companies.
10. Depending on the statement of a minority of scholars, that all commercial insurance contracts are permissible, insurance systems, regulations, and policies of insurance companies operating in the insurance market are legitimately acceptable.

In conclusion, it can be said that applicable insurance policies in Al-Rajhi *Takaful* comply with Islamic Sharia in general, whereas NCCI insurance policies are more in the line of commercial insurance than cooperative, which makes them inadmissible in Islamic Sharia, thus invalidating any dealings in them religiously or legitimately. This is based upon the provisions of Article 1 of the law on Supervision of Cooperative Insurance Companies: 'Insurance in the Kingdom shall be undertaken through registered insurance companies operating in a cooperative manner as it is provided within the article establishment of the National Company for Cooperative Insurance promulgated by Royal Decree M/5 dated 17/5/1405 H, and in accordance with the principles of Islamic Sharia'.⁵⁵ Therefore, a reformulation of the rules and regulations are seriously required, before a subsequent re-drafting of the insurance policies. It is clear that the fixed hypothesis of the study is true.

This chapter considered certain applications in NCCI and Al-Rajhi *Takaful* for the concept of Islamic cooperative insurance, in terms of model and existing regulations in the company, as well as financial policies in place, and the role of the Sharia Board in the evaluation of producing work without infringement to Islamic Sharia. The following chapter will be look to an Evaluation of the Application of Islamic Insurance Takaful.

⁵⁵ Law on Supervision of Cooperative Insurance Companies, available online: http://www.sama.gov.sa/Insurance/InsuranceLib/4600_C_InsuraLaw_Ar.pdf

CHAPTER 6: EVALUATION OF THE APPLICATION OF ISLAMIC INSURANCE TAKAFUL

6.1 Introduction:

Evaluating the applications and the experiences of the Islamic insurance concept Takaful is an important task. This chapter will evaluate the formulas and methods of attaining both Islamic and conventional insurance, considering commercial insurance, mutual insurance, and Islamic insurance. It is imperative to clarify all Sharia rules accordingly, with regard to the different insurance formula as described in the previous chapter, and to raise all objections to each formula and model, as presented by Islamic experts. The challenges facing the Islamic insurance industry may be determined through wider coverage of profitability proliferation of insurance needs, in terms of type horizontally and in terms of size and quality vertically. Finally, at the end of this chapter we will include some ideas for the possible enhancement of the Islamic insurance field.

6.2 The Formula of Insurance

Insurance formulas differ between organisations, however, if presented properly with companies in the private sector, they may be provided by the government or other organisations.¹ The following sections will critically evaluate each formula:

6.2.1 COMMERCIAL INSURANCE COMPANY

A commercial insurance company is like other companies in that it aims to generate profit; it has capital and shares to be traded within markets, and its main objective is to generate profit for the company owners who pay out its capital and own its shares. These types of insurance companies are always called ‘owners’ companies’ and are limited liability companies. Therefore, the highest point of responsibility for a shareholder is the value of money he pays out to shares. An insurer is a company, not a shareholder. A shareholder cannot withdraw from

¹ El Qora Daghi.A (2006). Islamic Insurance. Dar Albashaer Alislamiyah. Burit, Lebanon, p. 134.

the company, but he can sell his shares within the market. The insured buys an insurance policy and will then receive a commitment for compensation, regardless of the company's financial position. The worth of compensation is an outstanding debt to be paid by the company, which it is not allowed to profit from².

A formula that was prohibited as per the decision of councils and bodies³ was breached by some contemporaries with regard to its permissibility, including Sheikh Mustafa al-Zarqa.⁴ The justifications for this prohibition were in accordance with the decision of the Association Body, 1977. can be summed up as follows:

- 1- A deceit, as the insured cannot know how much they will give or take at the time of entering into a contract.
- 2- A form of gambling, because it is a fine without felony and a gain without charge, as well as being a gain with a non-equivalent charge.
- 3- It includes the usury *Riba*, as if a company pays to the insured more than it has paid to it, it is a giving usury *Riba Fadhl*, and as it is paid after a period of time, it is also increment usury *Riba nasee'a*.
- 4- It is some sort of forbidden bet, as it contains both ignorance and deceit through gambling.
- 5- It involves the taking of money without charge, which is against *Sharia* rules.
- 6- The legal obligation in insurance policy is itself an obligation that is not legally or legitimately required in *Sharia* teaching, because the insured did not initially cause a danger or any resulting damage.⁵

² Mishaal, A. (2009) 'The Evaluation of Cooperation Insurance Applications'. An Arabic paper presented at a cooperative insurance conference in Riyadh, p. 7 available online at: <http://iifef.com/files/taameen/09.pdf>

³ See Chapter 1, p. 41–51.

⁴ Alzarqa.M (1980) *The insurance system and Islamic Shari'a*. Islamic Economic book. Development conference in Damascus.p279. Alhamid.H.*The verdict of Shari'a on Insurance*. Dar Alitsam. Cairo.p16

⁵ El Qora Daghi.A (2006) *Islamic Insurance*, supra footnote 1, p. 135.

6.2.2 NON-PROFIT INSURANCE COMPANY (MUTUAL INSURANCE):

A non-profit insurance firm is a body owned by the policy holders (mutual insurance), as well as the insured, such as corporate shareholders who have the same rights as the non-corporate shareholders. It has no capital, as this is the result of the fees (i.e., the value of insurance policies) at the beginning of the company, which then accumulate reserves. The company pays an annual rent for the insured as an accounting profit; this may include work such as a re-evaluation of companies in a manner that covers risk adequately.⁶

The cooperative insurance formula, where the contributors are the policy holders, has its business run by a council on behalf of all participants. According to this formula, there are some applications from Sudan.⁷

Legislative standard has pointed to such a formula as the so-called cooperative insurance; with reference to the standard text of such insurance, management is funded by a body selected from among the policy holders. There is also a formula contained within the decision of the Association Body on the subject of insurance. The transfer of consensus on the inadmissibility of such a formula is supported by few contemporaries, as it is understood that there is no consensus on its permissibility due to the fact that the formula is contradictory.⁸

6.2.3 ISLAMIC INSURANCE COMPANY:

Islamic insurance companies did not appear until the issuance of the Islamic council Fatwas, which provided the cooperative insurance formula as an alternative to the legitimately forbidden commercial insurance.

⁶ Mishaal, A. (2009) The Evaluation of Cooperation Insurance Applications. Supra footnote 2, p. 8.

⁷ Gassem Aly El-Shamsy, The mechanism of transfer from traditional insurance to Islamic insurance, IOFI, Islamic Banking Conference 2008, p. 4.

⁸ Al Thanian.S (1993) Alta'min wa'hkamh, Cultural books for publishing, Edition1, Beirut, p 91–92.

Islamic insurance companies mainly specialise in money management and do not guarantee payment, as is the case with commercial insurance companies.⁹

A cooperative insurance company is in charge of planning portfolios for insurance against car accidents. It determines the nature of risk and then conducts appropriate actuarial calculations and designs as a compensation program. The company calls upon the one who wants to participate in the portfolio to pay a specific premium commensurate with the risk. It then collects the funds into the portfolio managed by its investment, as mentioned, for the benefit of its respective owners. These funds remain the property of shareholders; the task of the company is to manage the same for their benefit. In case of any incident befalling to any of them, the company withholds some deductions taken from the money and compensates the party to the agreed extent.

This portfolio is liquidated each year through the issuing of its final accounts. At the end of the year, if it is found that funds in the portfolio exceed the needs of people to whom compensation is due as a result of any negative impact, the company returns the exceeding amount to the participants of the portfolio. Furthermore, if funds are not sufficient to compensate all the people who have experienced a negative impact in that year, the company returns to the participants and asks them to pay an additional premium, as the idea of cooperative insurance is based upon 'solidarity' among participants in the portfolio, and does not guarantee compensation for affected participants, especially those who are no longer members of the portfolio. However, due to the difficulty of its claim to subscribers to pay an additional premium, the cooperative insurance companies provide interest-free loans from the owners of the company to the portfolio when it requires an increase, in order to return it in the next period. Therefore, the integration process takes place among participants in the present year, as well as those in preceding years.

The relationship of the company to the portfolio is based on agency, as it manages a portfolio for the fee of a lump sum stipulated in the agreement and, if profit will be achieved, the participants will take a portion thereof. Additionally, any loss is borne by them, as the agent is

⁹ For more information see Chapter 2.

entrusted and not guaranteed. This formula is most applicable to Middle Eastern and Arab countries¹⁰.

The relationship could be based upon trading off (*Mudarabah*), thus the company is a trader who runs the portfolio with a portion of the profit earned from the investment. In this instance, the company does not deserve a share of the profit achieved. This formula is most applicable in Malaysia.¹¹

The formula is considered to be the standard, according to the terminology of Islamic insurance and as per the provision of insurance standards in such formulas. It is a job conducted by a corporation for a certain payment, so as to manage insurance works and investment in the fund assets.¹²

The formula is not free of objections, however, as it was reported by Dr Rafiq Al-Masri that it is consistent with the opposition raised by Sheikh Taqi El-Othmani, see below:¹³

- 1- The grant is in return, for a grant is considered a financial reimbursement and is no longer a donation.
- 2- Deceit in this case is unforgivable, because the question relates to a financial reimbursement, not a donation.
- 3- Compensation from the gift of reward should be known, because it is part of the rule of sale, and compensation in insurance is unknown.
- 4- Obligation and the commitment to donate is problematic; supposing that it is acceptable, it should be returned in the form of a gift of reward.

¹⁰ Gasseem Aly El-Shamsy, supra footnote 7, p. 4. Mishaal, A. (2009) supra footnote 2, p. 10.

¹¹ Gasseem Aly El-Shamsy, p. 4.

¹² Mishaal, A. (2009) supra footnote 2, p. 11.

¹³ Al-Masri, R., El-Othmani. '*Is Wakf an alternative for cooperative insurance*', an abstract to Wednesday weekly Conversation in Islamic Economics Research Center, King Abdul-Aziz University, 19/10/2005.

6.3 Evaluation of the Islamic Insurance Industry

In preparation for this theses, a great deal of research and study was undertaken with regard to the Islamic insurance industry. The following conclusions were apparent:

1. The first Islamic insurance company was established in Sudan in 1977, but did not develop in the way in which Islamic banks are characterized¹⁴. There is no doubt that the tools and formulas of Islamic banks have evolved the level of investment and financing, followed by variations of sheltering and hedging; nevertheless, the formulas of Islamic insurance companies were frozen in terms of shape. They failed to provide some insurance services offered by traditional insurance companies, such as health insurance, or even car insurance, goods, and other properties that require the highest quality; although in terms of legitimacy they were not an obstacle to such developments¹⁵.
2. Contemporary applications of insurance do not lend any importance to the formula of cooperative insurance, as described in the Association Council Decision, and do not support such formulas, experiment, or even consider their effectiveness in achieving the purpose of insurance on properties and people in the first instance. Thus the industry remains in need of support for such applications of formula, in order to enrich the experience, diversify applications initially, and to be in accordance with a formula that is not exposed to the problematic concept of Islamic insurance, which is based on donation and management.¹⁶
3. The Islamic insurance industry in its current dominant form, based upon the formula of insurance management by an investment company with capital independent from the accounts of participants, is not an attractive formula for investment in terms of profitability. It may not allow the director to receive a profit from the process of insurance itself (i.e., from the Takaful Fund or the surplus), but

¹⁴ Islamic bank began work in 1975.

¹⁵Mishaal, A. (2009) supra footnote 2, p. 12.

¹⁶ El Qora Daghi.A (2006) Islamic Insurance, supra footnote 1, p. 138.

to profit instead from the management of the insurance process. Perhaps this explains the lack of exposure of the insurance industry in Islamic banks that were hijacked from usurers and non-Muslims, who do not believe in the concept and who are often from the East and West, and thus desire to achieve their money objectives through legitimate channels, acquiring a surplus of Islamic money.

4. Related to the above, is that traditional insurance companies have not yet experienced a great change of turning to Islamic companies. The transition has become a prominent feature in the last two decades at the level of traditional banking and investment, as well as in financing companies.
5. The Islamic insurance industry did not exceed the bottleneck with regard to the necessity for conducting reinsurance by an Islamic insurance company, rather than undertake it through a conventional insurance company on the basis of necessity or need. It does not appear that Islamic insurance companies in their current structure, based on a formula of either donation or management, are qualified enough to overcome this hurdle in the near future, but this structure may not allow for the existence of any attractive profitable elements. These would create insurance companies that would be capable of covering huge amounts of financial insurance for fleets of aircraft, ships, or the establishment of Islamic reinsurance companies.¹⁷
6. Many conferences and seminars have discussed cooperative insurance re-inventing the wheel, however, and reiterate the discussion of issues in relation to adapting cooperative insurance and the differences between this and commercial insurance. They then explore certain known and settled issues at the level of conventional insurance as a solution, such as insurance on debts. They do not find legitimate conditioning to be acceptable.¹⁸ Furthermore, based upon the legal documents that solve all problems of legitimacy, and especially the deceit, a donation is adjusted on the basis of the relationship between the participants, Takaful Fund, and the

¹⁷ Mishaal, A. (2009) supra footnote 2, p. 13.

¹⁸ See all Arabic papers presented in Cooperative Insurance Conference in Riyadh 2009. Available online at: <http://iifef.com/files/taameen/>

operator. Upon which basis the relationship between the insurance company and the Takaful account is adapted.

7. Straightforwardly, the challenges facing the Islamic insurance industry, which may be deduced from the above, are as follows:

Profitability.

Proliferation.

Wider coverage of insurance needs horizontally in terms of type, and vertically in terms of size.

Quality.¹⁹

8. The success of the Islamic insurance industry hinges on challenges requiring review, in the form of insurance based on donation and management as a single formula for the industry, which monopolised the term ‘Islamic insurance’ according to the terminology of the Islamic *Sharia* standard on insurance issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). Therefore, the capacity for research and development should be dedicated to finding alternative formats, which are more efficient in terms of economics and legitimacy. This thesis, however, adopts the idea of reconsideration of commercial insurance in its existing form, as well as considering the possibility of adapting to the legitimacy of acceptable formulas according to Islamic *Sharia* rules. This thesis attempts to cover some approaches that are supportive of the research in this respect.

6.4 Approach to the Need for Reconsideration of Insurance

This approach is confined to the addressing of insurance of ‘things’, not people; the reconsideration of insurance can apply to the latter, however, as some forms of governmental insurance can be easily apprehended from the perspective of this approach. The required reconsideration is in this case based on the need to tackle the reasons for the prohibition of the commercial insurance formula, which consists of deceit (*Gharar*) with financial

¹⁹Mishaal, A. (2009) *supra* footnote 2, p. 13.

reimbursement and gambling. Thus, destabilising the aforementioned reasons require discussion, analysis, and consideration of the possibility of denial and removal, while maintaining the image of modern commercial insurance as a formula based upon profitability and religiously acceptable methods, as follows:

6.4.1 Insurance specialists would themselves deny insurance gaming in practice in the insurance industry, and limit it with several conditions to keep it separate from gambling. However, Algari (2009) stated the similarities between gambling and commercial insurance, as well as the requirements that make insurance different from gambling, as follows:²⁰

6.4.1.1 Insurance resembles gambling in that both the gambler and the insured pays a fixed amount of money and then later receives another; he may earn that amount many times and will probably lose all of what he has paid to the insurance company. People still compare the insurance contract with gambling; indeed, it was stated that some judges in British courts in the eighteenth century did not see a difference between gambling and insurance. They did not need to originally judge that the insured should own an asset in order to insure it, because they were measuring it by virtue of gambling laws and governing it in conformity with the laws that organise risk and betting (as gambling was not forbidden to them) until the Marine Insurance Act was issued to prevent it in 1906 section 4(1) “Every contract of marine insurance by way of gaming or wagering is void”^{21,22}

6.4.2 Specialists of insurance note that there are certain substantial differences between insurance and gambling, and that the similarity does not deny the fact that the two contracts are different from each other for the following reasons:

²⁰ Algari.M (2009). *Cooperative Insurance*. Unpublished paper. However, this paper I have read its hard copy in (2009) and I am wondering whether it is published or not, also I tried hardly to find its published copy but there is nothing.

²¹ Marine Insurance Act MAI 1906. available online at:
<http://www.legislation.gov.uk/ukpga/Edw7/6/41/section/4>

²² See more Algamdi, E. (2006) *Insurable Interest in Property Insurance: A Comparative Study Amongst English, Canadian and Saudi Arabia Laws*. UNIVERSITY OF LONDON, UNIVERSITY COLLEGE LONDON, FACULTY OF LAWS 2006. P46-49

- 6.4.2.1 Mishaal (2009) stated that the gambler pays a sum of money to generate potential risk, upon which a loss of money paid is based, or a profit of that amount many times. This risk does not exist in nature, but is made by gamblers and only generated when each participant pays his stake in gambling (such as a lottery). At the end of game, a winner wins and a loser loses. However, insurance is concerned with something that is out of the will of all parties, relating to real risks resulting from acts of God, in consequence of fatal accidents, and the misfortunes that could affect wealth or children. Thus, the purpose of paying a premium is not to make profit from risk, but rather to protect oneself and compensate for damage. They differentiate from speculative risk, therefore, as it can be either profit or loss; risk in insurance is called pure risk, because it can only be a loss or keeping things as they are. For example, if a man bought some shares for investment purposes, he is liable for profit and loss: an insurance company cannot insure those shares against loss, as this is the first type of risk, and would become gambling, not insurance, if it conducted business.²³
- 6.4.2.2 Gambling is a means of becoming rich, because if the gambler benefits from such a game he grows richer than he was prior, and if he loses he becomes less affluent than before. Therefore, insurance is not merely a means of being rich, as it is limited only to compensation for damages, and concerns the same amount or even less.
- 6.4.3 There is no doubt that the reasoning adopted by the concept of insurance is negative, due to the fact that people use this method for the purpose of gambling. Therefore, laws governing the work of insurance, as well as companies specialising in this field, are keen to adopt new methods and to set out restrictions and procedures that ensure that an insurance contract does not turn into a means of gambling. For example:
- 6.4.3.1 Insurance companies do not accept insurance against all risks; the insured must be within insurable interest, which includes conditions such as the lessee having a direct interest in what is insured, like that of a property or car originally owned by

²³ Mishaal, A. (2009) *supra* footnote 2, p. 15.

the insured or mortgaged by them, provided that such interest would have existed at the time of incident. If there was an incident when an insurance policy was created (such as insuring a house), which then does not exist at the time of, for example, a fire (if the house is sold), the owner does not deserve compensation. The purpose of this requirement is so insurance cannot be seen as a means for dishonest enrichment.²⁴

6.4.3.2 Insurance coverage does not only fall to the extent of damage, as it is not a means to become wealthier or to generate incentives for the risk of speculating an incident, so as to gain the compensation. If the insured has protected his home from fire for the sum of £1 million, for example, which would have been the value of the house when the policy was issued, and if at the time of an incident occurring the value does not exceed £750,000, the insured may only get the second amount due to this being the amount of damage befalling to him at the time of incident.²⁵

6.4.3.3 Most regulations presented by insurance policies ensure the need for the insured to give up to the insurance company everything he can obtain as compensation for damage from the person who caused it. If he is insured and the incident is caused by an additional party and he deserves compensation, then he has no right to file a suit against this party and get compensation from him in excess of what he has received from the insurance company, as he is not worth anything. However, if what he gets from the insuring company is less than the amount of real damage, he will then get compensation from the party (or insurance company thereof) that is equal to the difference between these two amounts. Such laws give the insurance company the right to pursue associates in case of any damage that may occur and caused by an actor.²⁶

²⁴ Algamdi, E. (2006) *Insurable Interest in Property Insurance: A Comparative Study Amongst English, Canadian and Saudi Arabia Laws*. Supra footnote 22. P65 - 90.

²⁵ Mishaal, A. (2009) supra footnote 2, p. 16.

²⁶ Alrajhi Takaful, car comprehensive insurance policy, 2011, p. 4, article (20/5).

6.4.3.4 Laws in insurance policies do not allow for an asset to be insured by more than one company; if this does happen, the insured does not deserve to receive the amount equivalent to the damage shared between the insured persons.²⁷

6.4.3.5 Insurance of assets below their real value is not allowed, so the insured and the insurer will share the risk in order to reduce the so-called moral hazards in contracts. The insurance company obliges the insured by paying a portion of the amount of compensation as an excess²⁸ amount; this is for the purpose of keeping an insurance contract away from the realm of gambling.²⁹

6.5 The suspicion that insurance could be a form of gambling originated with the idea of an abstract guarantee with regard to money and work. Is it consequently possible to modify this abstract concept into a form of insurance that is linked to money and work themselves? Theoretically, it is conceivable that the answer is yes, but it seems there is an urgent need to put such formulas into practice and test them, explained as follows:

6.5.1 From the outset, it should be clear that the focus is on the prohibition of a guarantee without work, thus the modification of a guarantee is dependent upon the type of work that is legally considered to be a gateway to the passing of commercial insurance in its current form of profitability. In response to those who consider insurance permissible, it is confirmed that insurance is intended to provide a form of safety, and is a real benefit to be traded from.³⁰ However, Al-Suwailem (2009) has opposed this, saying that this statement demonstrates the imbalances in the insurance contract, as safety is not only to encounter risk and that the presence of security equates to the absence of fear and a lack of risk. While the insurance company does not aim to protect the insured asset, nor to prevent risks entailed, which is not the intention of any contract, it does aim to financially reimburse the effects of a particular risk. Therefore, if there is loss, the company compensates the insured person, as formally agreed.

²⁷ Ibid., article 6.14.

²⁸ The North American term is **deductible**.

²⁹ Mishaal, A. (2009) *supra* footnote 2, p. 17.

³⁰ El Qora Daghi.A (2006) *Islamic Insurance*, *supra* footnote 1, p. 151–54.

However, the difference between prevention of risk and compensation of subsequent effects may prove confusing for many people, thus in Islamic *Sharia* jurisprudence preventing a risk is work and the contract of this work is a honesty contract,³¹ while the contract to compensate the effects of risk is a guarantee contract. So the insurance contract is a guarantee contract due to it being a financial reimbursement between the premium and the amount of compensation. There is no reason why work should feature in such financial reimbursement. This is unlike commercial contracts, which reduce the potential risks by, for example, guarding, as the guardian contract is a honesty contract and thus a physical work that would reduce the likelihood of risk, whereas an insurance contract is a financial reimbursement contract on the warranty, wherein there is no room for work. On the other hand, insurance contracts do provide that, should a risk lie outside the authority of the insured person. Therefore, from the evidence, it is clear that if the work of the insurance company is to prevent risk, it is a permissible form of work, which receives an insurance premium as a reward for such work.³²

6.5.2 Linking insurance with money or work, however, turns a guarantee into a legitimate reason for attaining profit, which is in accordance with Islamic *Sharia* pursuant to legitimate rule (*Alkharaj-bi-aldaman*).³³ Consequently, the insured gains the security, considered to be *Alkharaj*, and will pay a premium for a deserved guarantee. Therefore, if this was an accepted idea, the thinking should then be focused on how to convert the guarantee from an insurance company into a dependent guarantee for money or work. Simply put, in case the work is used by the concept of a guardian contract by an insurance company acting as a guard for certain types of property, the insurance contract then involves a form of work and a guarantee is therefore based

³¹ In Islamic *Sharia fiqh* contracts, all contracts are categorised to many different types, such as DONATION CONTRACT, A FINANCIAL REIMBURSEMENT CONTRACT (*Muawadah*), OBLIGATORY CONTRACT, A SUBMISSION CONTRACT, etc. **The Honesty contract** is one of them, therefore under each type there are plenty of applications and sub-contracts. For more information, see to Alzarga, M. *Almadkhal Alfiqhi Alaam*. Pablished by Dar Alqalam, Damascus edition (2004) p. 630–47.

³² Alswailim, S. (2009) makes a standpoint in cooperation insurance, an Arabic paper presented at a cooperative insurance conference in Riyadh, p. 16, available online at: <http://iifef.com/files/taameen/09.pdf>

³³ This rule in Islamic jurisprudence is the answer to many financial transactions that take place between buyer and seller, so *alkharaj* means the profit or the gain, and *bi-Aldaman* means the warranty. The concept of this rule is that, unless the buyer gets a benefit from the transaction, they should provide a guarantee for during the time in which the commodity was held. For more information, see Alshafee, *Alum*. An Arabic book published by Dar Almaarifa Beirut (1990), available online at:

http://www.islamweb.net/newlibrary/display_book.php?idfrom=6120&idto=6120&bk_no=31&ID=2484

upon a guard in the event of damage. As for the guarantee associated with money or property, it is easy to imagine that an insurance company would own movable goods, such as import and export goods, from their source and subsequently transfer ownership to the insured after the end of the period of risk. They would then take compensation plus the price of cost, as stated in the insurance premium. This solution could be a significant burden on the insurance company through ownership of all of what it is going to be covered by such policies, and later paid for. However, the natural gap between freight and paying out the price to the supplier can be exploited, as the insurance company can postpone the payment until the sale of the goods. The guarantee associated with money and work, as with insurance on homes and palaces, requires some equipment to either be sold by the insurance company or that an insurance company must be involved in the maintenance, in addition to the necessary guarding.³⁴

6.5 Conclusion:

Some of the proposals expounded in this essay may seem inapplicable at first glance, and may be a shock to some researchers. However, the importance of such ideas can be confirmed as a means of stimulating researchers to think seriously about the possibility of development in the insurance industry through a profitability formula. In other words, if the Islamic financial industry has an Islamic insurance formula based upon financial reimbursement, it would adequately generate an incentive for the establishment of Islamic insurance companies with huge capitals, which would cover all insurance needs regardless of value, and allow the establishment of Islamic reinsurance companies as well.

In conclusion to this research, the following can be recommended:

- 1) The importance of working with government agencies and Islamic financial institutions, as well as Islamic insurance companies, to activate the application of cooperative insurance formula, in which policy holders run the company according to the formula established by the decision of the Muslim World League Council in 1978.

³⁴ Mishaal, A. (2009) supra footnote 2, p. 18.

- 2) To mobilise the efforts of the researchers within research bodies in universities and support institutions at the level of the Islamic financial industry to reconsider the Islamisation of commercial insurance on properties in their current formula. This is based upon financial reimbursement through the modification of the idea of an abstract guarantee into the idea of money or work, as well as the suggestion of certain methods for transforming this idea into a practical reality, via the according formulation of insurance products.

CHAPTER 7: CONCLUSION;

7.1 Summary of the key point in this thesis

7.1.1 INTRODUCTION

Commercial insurance was imported to Arab countries from the west in the 19th century and introduced a foreign concept to Muslim Arabs. The emergence of insurance contracts in Arab and Muslim countries has meant that Islamic scholars and legal experts now pay considerable attention to this matter.

Muslim scholars have varying opinions about insurance. Insurance policies that earn interest are generally considered to be a form of *Riba* (usury) and some even consider policies that do not earn interest to be a form of *gharar* (uncertainty). Some argue that *gharar* is not present due to the actuarial science that underpins the underwriting.

However, Insurance is theoretically acceptable to the Islamic mindset; therefore, Al Sanhoury (1964), stresses Insurance as being only an organised form of co-operation between a group of people. One that is intended to pay for risks and therefore subdivided, so that if some were at risk, everyone faces it together with only a small sacrifice from everyone; this means, that then they can avoid severe risk and damages that would have beset them without this cooperation¹. Al Zarqa (1980) adds that the concept informing the minds of *Sharia* law scholars regarding the insurance system is that it is a cooperative solidarity system which leads to fragmentation of the parts associated with risk and calamities that are then distributed among group insured persons through the use of compensation to pay an injured person from the proceeds of premiums instead of damage being the responsibility of the injured alone. It is often said that Islam in all its legislations concerning the organisation of social and economic life aims to establish a society based on mutual cooperation and absolute solidarity of rights and duties².

¹ Alsanhoury. *Alwaseet*. Supra.v7, p.1218

² Alzarqa, M. (1980). *The insurance system and Islamic Shari'a*. Islamic Economic book. Development conference in Damascus.p279. Alhamid, H. *The verdict of Shari'a on Insurance*. Cairo: Dar Alitsam, p16.

On this basis, there is no doubt that this idea is acceptable in Islamic law and consistent with the purposes of the law to cooperate for better outcomes; it is an Islamic demand underpinning the majority of the provisions of *Sharia*, as it called for cooperation and social solidarity, Furthermore, Islam has enjoined *Zakat* and instituted a system describing it for the deserving poor, debtors, and wayfarers so long as it remains within the lines of expenditure for protection; also offering a system of expenditure on relatives, and a system of ransoms “*Alaaqlah*”³, in addition to the duty of the State in providing a proper life for individuals and in assuming its responsibility to pay debts for individuals in case of death with nothing left to creditors.

However, from the perspective of Islamic law, the problem of the applied aspect of insurance is represented in the drafting of contracts in the light of capitalist thought, which does not observe religious aspects, making the aim to profit in any way possible. This may lead us to accept the notion, as mentioned previously, to change such contracts and means to make them comply with the principles and concepts of Islamic law, taking into account such projects as profitable business.

This chapter will present a summary of the critical issues that have been discussed, analysed and explored in this thesis.

7.1.2 THE MODELS OF TAKAFUL

Takaful in recent times has been recognised by modern Islamic experts as an alternative product to offer conventional insurance. This is because it is free from unlawful elements like gambling, *Riba* (usury) and uncertainty. The thesis identified the subject matter of the *Takaful* contract by answering the question; Do *Takaful* applications provide suitable solutions to resolve insurance problems?

However, there are significant discussions amongst modern experts concerning *Takaful* and the extent to which it is a pure donation contract, a cooperative mutual contract or a contract of exchange in relation to conventional insurance. In the analysis of the models and their approaches, I have studied all the models applied worldwide which are:

- *Mudarabah* Model;

³ *Supra*, chpter 2, footnote 117.

- Wakhalah with fee Model;
- Whakalah with *Waqf* Model; and
- the hyper model Agency-*Mudarabah* model.

However, I discovered that the *Mudarabah* and the *Wakalah* are contracts of exchange (*Muawadah*). Thus, there is no difference between conventional insurance and mutual insurance because both clearly include the elements of exchange (*Muawadah*); so the policyholders apply to the company to obtain compensation from the fund, but the element of doubt remains as to receipt of compensation. The only real reason for a policy holder to apply to such a fund is because it is restricted to policyholders only.

The only model I found which complies with Islamic *Sharia* law is *Wakalah* with *Waqf*.

The South African *Takaful* introduces 10% administration fees – to be collected from gross premiums (this means *Waqf* assets and its profits). This application means it is then non-compliant with Islamic *Sharia* law because the fee of the agent (*nazer-u-alWaqf*, as confirmed in all *Fiqhi* schools) must be collected from the surplus only; not from the *Waqf* Fund, unless the participant knows in advance that an administration fee will be collected from the premium, in which case the intention of the donor in this situation will then be different and so will comply with *Sharia*, because the intention of the payment will be split into two parts; one for the *Waqf* and the other for the administration fee.

However, nowadays, *Takaful* has become a system rather than a financial product. This makes it more preferential than conventional insurance. Policy holders can collect profits and create a savings pattern through such investments. Further, *Takaful* can be considered a new income channel on the grounds of support by a social institution, and thereby benefit the spending (*Infaq*) sector.

7.1.3 SAUDI INSURANCE LAW

The importance of analysing Saudi Insurance laws and regulations is that Saudi Arabia confirms Islamic *Sharia* as the constitution of the Kingdom⁴, so that logically all rules

⁴ The Basic Law of Governance, Part one General Principles, Art.1.

applied, particularly, in the case of Insurance law must comply with Islamic *Sharia* teaching and any regulation or statute that violates *Sharia* principles should be void and have, in principle, no effect. Therefore, the question asked is: To what extent does the legal framework of insurance in Saudi Arabia comply with Sharia law?

Answering this question was difficult and I have critiqued the Saudi insurance system from the perspective of Islamic *Sharia* Law from multiple perspectives and found the following;

1. There is a mistake in the Legal constitution. Art. 1; The Law on Supervision of Cooperative Insurance Companies stipulates that “Insurance in the Kingdom shall be undertaken through registered insurance companies operating in a cooperative manner as it is provided within the article establishment of the National Company for Cooperative Insurance....”⁵ However, this is a clear mistake in constitutional drafting. Many people interested in insurance are in a state of contradiction, about how the statute of the company is agreed upon by many researchers that are exercising an insurance business forbidden in some applications and provided by the system as an example that should be traced. Furthermore, the article added that: "in accordance with the principles of Islamic *Shari'a*"; such an addition is definitely in line with the regime in the country and is based upon the fact that the legislature, when drafting such a system was aware that the National Company for Cooperative Insurance is subject to criticism as far as Sharia scholars in the Kingdom are concerned.
2. The concept of insurance in Saudi Arabia is similar to that associated with conventional insurance from the perspective of the logic of the application.
3. The Law on Supervision of Cooperative Insurance Companies and The Rules attributable to the Council of Cooperative Health Insurance and their implementation regulations do not reflect what is supposed to be in insurance in an Islamic concept based on donation; but they reflect the concept of conventional insurance based on a clear *financial reimbursement contract (Muawadah)*.
4. All contracts between companies and insured persons take the form of a *financial reimbursement contract* and include a *Gharar* which makes this kind of contract void.
5. The relationship between the company and the total insured may be qualified as a fee based agency for the management and regulation of insurance with the *deceit (Gharar)* in the wage, and thus the fee based agency contract is void. On the other hand, what is

⁵ Supra. Foot note 6.

relevant to the investment of funds, is that the company is a joint trader (*mudarib*), so that each policyholder is an owner of the capital (*Rabuallmal*), whereas it is also an absolute trading point. This then is still restricted in terms of time because the contract period is only one year; therefore, I can confirm that according to Islamic rules of *Mudarabah* this invented application is void as well, for two reasons, the first is ignorance in the amount of capital and the second is that the company would take a share of the surplus, which it is not entitled to take.

6. The distribution of the surplus does not reflect what should be an Islamic insurance concept. The shareholders and the Cooperative Health Insurance Council invoke a non-permissible right that involves depriving policyholders of their rights; insurance companies receive a part of the surplus, which is not an income achieved by the company, and that is exactly the case for the Council of Cooperative Health Insurance.
7. The existence of investment funds does not follow Islamic Sharia rules as this makes trade with companies forbidden. An Islamic finance company must follow Islamic rules and all transactions should be considered as permissible *Halal* financial products even in terms of assets and investment⁶. However, Article 61 of the Implementing Regulations confirms the allowance of all companies to invest in items representing *riba*-based investment activities, such as Foreign and Government Bonds, Saudi Riyals Denominated Investment Funds and Foreign Currency, etc.
8. The legitimacy of cooperative insurance in Islamic thought does not necessarily mean the legitimacy of the applications of the Insurance companies.
9. The existence of an Islamic Sharia committee within insurance companies does not guarantee the legitimacy of the contracts or the financial treatments and transactions made by these companies.

Therefore, I do believe that the Saudi governor should set up an independent central Sharia board and give it all necessary authorisation for the observation and redrafting of all articles as criticised in this thesis and by researchers and Islamic scholars.

⁶ For, example trading in wine in Islamic Sharia is forbidden, therefore, all wine company's shares are forbidden and not permissible for trading.

7.1.4 THE CASE STUDIES IN THIS THESIS

Using a qualitative methodology, the aim of this study was to evaluate the impact of the law on Supervision of Cooperative Insurance Companies, as well as the Council of Cooperative Health Insurance and their regulations affecting the applications of the National Company of Cooperative Insurance NCCI, as well as Al-Rajhi *Takaful*, and in so doing to find the answer to the following question;

Do the applications of Takaful companies in Saudi Arabia meet Sharia law requirements?

Therefore, to find precise outputs the study included policies designed according to the Saudi Arabian Monetary Agency SAMA. Evaluations were carried out on the doctrine of the companies, in addition to practical applications of the model and eventually also exploring the objectives of cooperative insurance, surplus distribution, and investment in insurance funds.

Ultimately, the study revealed the following:

1. Saudi insurance law is similar to conventional insurance thought, in terms of the purpose of the insurance, and in both constructive theory and insurance practice, even that which has been asserted in the law to be in accordance with Islamic Sharia.
2. The law on Supervision of Cooperative Insurance Companies and how it implements regulations, and the rule of the Cooperative Health Insurance Council and its implementation regulations, does not reflect presumed insurance, as per Islamic thought, in terms of donations. It reflects the concept of insurance in terms of conventional thought, which is based upon reimbursement, and the possibilities and obligations of both parties.
3. The insurance policies of the National Company of Cooperative Insurance NCCI do not reflect the requirement of cooperative insurance in Islamic thought in terms of donations, but rather the concept of insurance in terms of conventional thought on reimbursement, as the items in policies in many provisions provide explicit evidence towards the will for reimbursement.
4. NCCI insurance contracts, in view of the relationship of one policyholder to the remainder of the policyholders, represent financial reimbursement within the body which is an obscene deceit and thus nullified as per Islamic Sharia. Al-Rajhi *Takaful*, on the other hand, has succeeded in applying the donation concept to its

contracts and removing the deceit therein, ensuring they comply with Islamic Sharia.

5. The distribution of surplus at NCCI does not reflect a necessity in view of Islamic thought, whereas *Al-Rajhi Takaful* did succeed in correcting the fault in the implementing regulation, Article 70/2/c, d, and e, and so is in line with Islamic Sharia.
6. The presence of investment funds in NCCI, which are in violation of Islamic Sharia, affects the permissibility of dealing with such companies.
7. The legitimacy of cooperative insurance, as based upon the proven assumption that it does not necessarily equate to the legitimacy of existing applications, is referred to as cooperative insurance.
8. The existence of a Sharia Board bodies within a number of insurance companies does not necessarily guarantee the legitimacy of the contracts or transactions of such companies. Therefore, Sharia Board bodies must be independent, so as not to be subject to conflicts of interest.
9. Contemporary insurance companies reflect the school of thought applied by insurance companies for the Sharia Board, which is demonstrated through its approval of contracts and the transactions of such companies.
10. Depending on the statement of a minority of scholars, that all commercial insurance contracts are permissible, insurance systems, regulations, and the policies of insurance companies operating within the insurance market can be accepted as legitimate.

It can be observed that applicable insurance policies in *Al-Rajhi Takaful* comply with Islamic Sharia in general, whereas NCCI insurance policies are more in the line with commercial insurance than cooperative, which makes them inadmissible in Islamic Sharia, thus invalidating any dealings in them. This is based upon the provisions of Article 1 of the law on Supervision of Cooperative Insurance Companies: ‘Insurance in the Kingdom shall be undertaken through registered insurance companies operating in a cooperative manner as it is provided within the article establishment of the National Company for Cooperative Insurance promulgated by Royal Decree M/5 dated 17/5/1405 H, and in accordance with the principles

of Islamic Sharia⁷. Therefore, a reformulation of the rules and regulations is urgently required, to precede any subsequent re-drafting of the insurance policies. It is evident that the fixed hypotheses in this study are true.

7.2 Recommendations

I believe that the main objective of this thesis is to contribute rational, scientific and specific recommendations to improve regulatory effectiveness in Saudi Arabia, and I can confirm all are relevant to SAMA.

Thus, this thesis adopts the following recommendations;

- 1) To stress the importance of working with government agencies and Islamic financial institutions, as well as Islamic insurance companies, to activate the application of cooperative insurance formula or *Takaful*, in which policy holders run the company according to the formula established by the decision of the Muslim World League Council in 1978.
- 2) The Saudi insurance market has some negative points regarding the level of regulations or applications. Therefore, SAMA is responsible for paying more attention in this regards to persuade insurers to operate in line with the principles of *Sharia*. SAMA should establish an independent body (Central Islamic Supervisory Sharia Board). This body could provide positive advice to the Saudi insurance sector and explain to the public, issues to consider regarding insurance. Thus:
 - I. The Central Islamic Supervisory Sharia Board can gather with Senior Sharia scholars and financial specialists to devise solutions to any Islamic insurance issues may arise in Saudi insurance sector.
 - II. The Central Islamic Supervisory Sharia Board should demand pure Islamic *Takaful* regulations and applications for insurance companies and demand correction to all actions that do not comply completely with *Sharia*; such as investment and surplus of policyholders' premiums.

⁷ Law on Supervision of Cooperative Insurance Companies, [Available online: http://www.sama.gov.sa/Insurance/InsuranceLib/4600_C_InsuraLaw_Ar.pdf, viewed June 2012].

- III. The Central Islamic Supervisory Sharia Board should revise all insurance laws and implementing regulations and raise all legal suggestions and drafting to SAMA to finalise the proper procedure.
- IV. The Central Islamic Supervisory Sharia Board should supervise and ensure that all its considered decisions and rules are accurately applied by all insurance companies.

Based on this, I am sure that this body and any actions it proposed will increase the level of confidence among people and improve the reputation of the Saudi insurance market. Also, they will serve to enhance public awareness of the importance of insurance needs, and will accordingly lead to increased demand for insurance products amongst Saudi society.

- 3) SAMA should adopt an institute of insurance and accordingly run courses in Insurance to enhance the technical knowledge in this sector.
- 4) It is necessary also to emphasise the importance of mobilising the efforts of researchers within research bodies in universities and supportive institutions at the level of the Islamic financial industry to reconsider the Islamisation of commercial insurance on products in their current formula. This formula is based upon financial reimbursement, and is a modification of the idea of an abstract guarantee associated with the idea of money or work⁸, as well as a suggestion of certain methods for transforming this idea into a practical reality, via the formulation accorded to insurance products.

7.3 Suggestions for further work.

This study has concentrated on presenting the material from a legal perspective, therefore it did not extend to an examination of the general absence of public awareness about insurance in Saudi Arabia or the challenges or weaknesses faced by insurance companies in the country because both are closer to finance than legal matters. However, there are some additional legal subjects that should also be covered by researchers such as the fraud risk in the Saudi insurance market, and the extent to which it is committed by insurance companies or intermediaries selling insurance without a license or failing to compensate policyholders or people who are using insurance policies improperly. I do believe that further research is

⁸ See more in chapter 6. P.14.

required for each subject separately or possibly comparative research; e.g. focusing on general absence and fraud risk, to determine whether there is a clear relationship or manifold differences.

GLOSSARY

1. *Al-Mudarabahh*: *Al-Mudarabahh* is a financial technique applied via Islamic business partnerships, between two or more parties, where one party provides capital while the other offers a valuable service or skill, in a particular business, each sharing profits accordingly. Today's Islamic banks and Islamic insurance companies operate based on the principles of *Mudarabahh*, an alternative to the interest based-transaction. In other words, *Mudarabahh* involves interest free profits and loss sharing transactions.
2. *Alaaqlah*: *Alaaqlah* are the male factions of a tribe whom relevant to the killer from his father's side. Here, Arab traditions advocate that, in the case of murder, the *Alaaqlah* collect blood money (*Diyah*) from each of the tribe's males to be paid to the victim's family.
3. *al-iltizam bi alta'weed*: the obligation to indemnify.
4. *Alkharaj-bi-aldaman*: In Islamic jurisprudence, the term *Alkharaj-bi-aldaman* relates to a large proportion of financial transactions that take place between buyer and seller. Basically, *alkharaj* means the profit or the gain, and *bi-Aldaman* represents the warranty. The assumption behind this rule encourages that, unless a buyer gains immediate benefit from the transaction, he/she should be provided with a guarantee during the period in which a commodity is being held.
5. *Almunahadah*: *Almunahadah* is a type of company promoting companionship, where members place food on one sheet and distribute it among themselves equally.
6. *Alrushud*: reaches mature mind.
7. *alsiyasah al-shari'yyah*: it is an Islamic principle means the Legitimacy Policy.
8. *Alwali*: guardian.

9. *Anan Company*: In Islamic *Fiqhi*, an *Anan* company is a partnership whereby both partners invest a definite sum of money and definitely profit share.
10. *Aqd*: contract.
11. *BOTTOMRY* : A ancient type of insurance when the master of a ship signifies money borrowed against the *bottom* or keel of it; this forfeits the ship itself to the creditor, if the money is not paid at the time appointed with interest at the ship's safe return.
12. *FIQHI*: *Fiqhi* refers to Islamic jurisprudence which deals with the observance of rituals, morals and social legislation. *Fiqhi* is an expansion of *Sharia* law based directly on the Quran and *Sunnah* complementing the evolving rulings/interpretations of Islamic jurists .
13. *Fiqhi*: Islamic Jurisprudence.
14. *Gharar*: uncertainty.
15. *hibah althawab*: gift for compensation.
16. *hibah mutlaqa*: absolute gift.
17. *Hibba*: gift.
18. Holy Quran: divine book of Muslims, the main source of sharia law.
19. *Ijarah*: rental.
20. *Infaq*: spending.
21. *Jahalah*: ignorance.
22. *Jua'la*: *Jua'la* is an Arabic term, 'an agreement where one party commits to pay a determined sum to the second party upon achievement of a specific result at either a specified or unspecified time'.
23. *kheyar al'aaib*: defect option.
24. *kheyar alwasf*: option of description.
25. *Mahalul-Aqad*: Contract subject matter.
26. *Masalaha mu'tabara*: valid public or donator interest.
27. *mu'awadah*: reimbursement.

28. *Muamalat*: Commercial transactions.
29. *Mudarabah*: share in profit.
30. *Mudarib*: means entrepreneur. *Mudarib* is basically the trader or person carrying out business in line with the *Mudarabah* model, thus sharing subsequent profits or losses accordingly.
31. *Mufawadah*: *Mufawadah* represents a transaction in Islamic law where each member of the contractual party deputises the other in all matters relating to money and management. *Mufawadah* is prohibited by the Hnbali, Maliki and Shafee schools because it constitutes a guarantee despite the element of ignorance hindering both parties (*Jahalah*). Hence, in Islamic law, an individual cannot say “I will guarantee you” and/or “make you an agent in”, as the subject matter must be defined in both contracts. However, this is not the case with contracts based on *Mufawadah*.
32. *Musharaka*: partnership.
33. *Musharakah* : Means Partnership.
34. *Nazer- u- alWaqf*: is the person or entity that looks after the endowment (*waqaf*).
35. *Rabui-ul-Mal*: capital owner.
36. *Ra's-ul-Mal*: capital money.
37. *Riba Alfazal*: is intended to increase an indemnity in a unified manner for example where wheat is exchanged for wheat, with a certain increase
38. *Riba Alnaseiaa*: is a loan of money taken for a known period of time, proportional to increases in the amount of the loan and accordingly, increases in debt, as well as duration.
39. *Riba*: usury or interest.
40. *Sharia*: The system of Islamic law which is based on the teachings of the Holy Quran and Sunnah.
41. *SOKRAH*: The word (*SOKRAH*) originally comes from a French word ‘*securite*’, and in Arabic, means insurance or guarantee.

42. *Sunnah*: The traditions and sayings of Prophet Mohammed (SAW), this is the second most important source of Sharia law.
43. *Ta'awun* : mutual assistance.
44. *tabadul al-qurud*: mutual exchange of loans.
45. *Tabarru*: voluntary contribution.
46. *Tabaruu al-mukarama*: generosity donation.
47. *Takaful*: *Takaful* is an Arabic term meaning mutual responsibility, used as an alternative term to Islamic insurance.
48. *Takharuj and Mubarahah*: These are Arabic terms employed linguistically to convey the process of getting out of, or being released from, or disappearing from, a contract for example. In a more technical sense, term refers to the legal procedures involved in participant cancellation of an insurance policy, be they the company or an individual.
49. *Tameez*: a discerning minor.
50. *uqala'a*: persons of senses
51. *Wakalah*: agency
52. *Wakeel*: agent.
53. *Wakf*: endowment.
54. *Walaa almualah*: is a contract in Islamic sharia means the loyalty contract.
55. *Waqf*: This term embodies charity, religious endowment and the testamentary bequest of real estate. In Sharia law, *Waqf* also denotes the termination of an asset and/or the transfer of ownership of valuable property into the ownership of Allah, declaring perpetual usufruct for religious, charitable or pious purposes.
56. *Wasiyyah*: will
57. *Zakat al-Fitr*: an obligation charity to be paid directly after Ramadan (the month of fasting for Muslims).
58. *Zakat*: an obligation charity.

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