CHAPTER – VI

COMPARISON BETWEEN INSURANCE UNDER COMMON AS WELL AS ISLAMIC LEGAL SYSTEM
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If a person is engaged in business, he or she is exposed to struggle and faces many risks. These hazards, many of nature’s own doing and more arising out of his or her economic activities are inevitable concomitants of life and one would try to overcome. His or her instinct to survive has moved him to devise appropriate means of dealing these hazards. The present economic progress is itself a proof of the measure of his or her success in this endeavour and by its contribution towards this achievement. Insurance has earned the pride place as the handmaiden industry and commerce. Here is the brief distinction of the principles of insurance under common legal system as well as Islamic Legal System, for the purpose of giving in hand knowledge to the people. This sort of exposition will give an opportunity to the persons to see the viability and profitability of both the systems.

The basic differences between both the systems can be summed up as follows:

(1) Differences in Origin

The idea of insurance under common legal system began with the practices of Babylonians and their civilization, which flourished some 3,000 years B.C. The Babylonian Code, now known as Code of Hammurabi, was compiled by the King of Babylon around 2250 B.C. and contained some 282 clauses. The code showed that the ancient Babylonians used to practice commercial contracts involving money transactions, in which people lent their money to merchants for a certain percentage of interest. These money transactions subsequently became known to the world as the contract of Bottomery. Bottomery was introduced by the merchants of Babylon, at about 4000-3000 B.C. The nature of it was that money or goods were advanced to merchants for trade purposes. These transactions between the lender and the
borrower were on the mutual understanding, that in consideration of the interest payment, the borrower should be protected from liability against unexpected and accidental happenings in trade. These payments of interest in Bottomery bear a resemblance to today's premium. The borrower (merchant) can be compared to the insured, while the lender played the role of the insurer, and had the responsibility of protecting the borrower from liability arising from any unexpected occurrences and accident in the course of trade in consideration for the interest paid. It may be concluded that today's insurance practices under common legal system in fact originated from the practices of the contract of Bottomery of the ancient era.¹

On the other hand insurance under Islamic legal system has its birth in the ancient Arab tribal customs of "Al-Aqila" before 570 C.E. The word "aqila" means 'asabah', which denotes the paternal relatives of the killer. Under the custom of "al-aqila", it is mutually agreed among the tribes that if a person is killed unintentionally by a person of a different tribe, the accuser's paternal relatives will take the responsibility to make a financial contribution for the purpose of paying blood money to the victims, family or relatives. Such readiness to make monetary contributions is similar to the premiums paid insurance practices. While the compensation paid under "al-aqila" could be similar to the indemnity in today's insurance practice, as it is a kind of mutual financial protection for the heir upon the unexpected death of the victim. It may be concluded that today's insurance practices under Islamic legal system originated from the custom of "al-aqila".²

(2) Differences in Rationale

Under common legal system it is seen that the need for insurance arose upon realising the need to protect the community against unexpected risks. It is actually an important fact that an insurance policy provides material protection against unexpected risk to both, the individual and the community

as a whole. Insurance provides an assurance of compensation against an unpredicted losses and it paves the way for social solidarity. This is because the insured pays money to the insurer (the insurance company) enabling it to run a business, while the insurer undertakes to provide the insured with the necessary material protection against an unexpected risk. Such co-operation certainly leads to brotherhood, not only between the policy holder and the insurer, but also within society in general.\(^3\)

On the other hand rationale of insurance under Islamic legal system does not signify a chance for material gain nor supersede the power of Almighty Allah in one's life, death or destiny, but it aims at achieving the pleasure of Almighty Allah through the concept of mutual help and cooperation with the goal of providing material assistance against unexpected future, damage or loss. Allah does not prohibit one from making any effort in overcoming difficulties or obstacles in life. An insurance policy enables certain people to be rescued from unexpected future material risk, which may lead them to hardship or misfortune. The Holy Prophet (PBUH) advised the Ummah to come forward in relieving one's hardship. The Holy Prophet (PBUH) reported to have said:

"Whosoever removes a worldly hardship from a believer Allah will remove from him one of the hardships of the hereafter. Whosoever alleviates the needy person, Allah will alleviate from him in this world and the next..."\(^4\)

An insurance policy reduces poverty in society, while ensuring a comfortable life for the insured and also for his beneficiaries. Any one might face financial constraints as a result of an unexpected occurrence which causes material loss or damage. Such material hardship could be alleviated if one has an insurance policy, hence guarantees the insured a comfortable life or material security even after unexpected occurrences of loss or risk. Almighty

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Allah indeed encourages people to seek a better life in both this world and hereafter when Allah says:

...our Lord give us good in this world and good in the hereafter...⁵

Having an insurance policy may ensure a development of mutual cooperation and the spirit of the brotherhood in society, and also cultivate solidarity through seeking a prosperous life.⁶

(3) Differences in the course of Development

The development of insurance under Common legal system started from the practice of the contract of Bottomary. The working of contract of Bottomary was based on the practice of interest. Even today the development of the principles and practices under common legal system remains under the principles of interest.⁷

On the other hand development of insurance under Islamic legal system started from the practices of doctrine of “al-aqila”. The working of doctrine of “al-aqila” was based on the basis of mutual co-operation among the Arab tribes. The development of contemporary time of Islamic insurance practices are based on the principles of ‘al-mudharbah’, where the parties involved share the profits in an agreed portion, while simultaneously avoiding the consumption of interest (riba).⁸

(4) Differences in Meaning

Insurance under common legal system is a contract between the insurance company and the policyholder, whereby the insurance company is required to pay monetary compensation to the policyholder in the event of misfortune.

Whereas insurance under Islamic legal system is a contract between a pool of persons and the manager of the risk pool (takaful operator) wherein

⁵. Il. 201.
⁶. See Billah, op.cit, pp. 40-41.
⁸. See Billah, op.cit, p. 40.
they pay a certain sum of money as contributions or donations for the purpose of assisting each other in times of misfortune.

(5) Differences in Essentials

A contract of insurance under common legal system must satisfy all the valid requirements of a legally binding contract without this contract of insurance will loose its validity.

Whereas the contract of insurance under Islamic legal system possess the following essential ingredients, i.e.

(i) Sincerity (ii) Shariah Principles (iii) Presence of Moral Attributes
(iv) The Essentials of an Insurance Contract

(6) Differences in Principle

Insurable interest is a basic principle of insurance under common legal system. It means that the party to insurance contract who is the insured or policyholder must have a particular relationship with the subject matter of the insurance, whether that be a life or property or a liability to which he might be exposed. The absence of required relationship will render the contract illegal, void or unenforceable depending upon the type of insurance.

On the other hand the governing principle of insurance under Islamic legal system is also insurable interest. Conformity to the principles of insurable interest in an insurance policy is one of the fundamental aspect of Islamic insurance. It is required that statutory provisions should contain comprehensive provisions relating to insurable interest justified by the Shariah sanctions. In relation to this, it is suggested that the general principles of insurable interest should be based on the principles of Faraid, in which the benefits over the policy should be regarded as the estate of the participant. Further that, insurable interest can only be vested on those, who according to

the general principles of Faraid, have the benefit rights over the estate of the participant after his death.  

(7) Differences in Parties

There are two parties under an insurance contract under common legal system. One of the party is Insurer i.e. a person who undertakes to make good the loss is called insured. The other party is known as Assured i.e. a person whose loss is to be made good, is called the assured. The consideration for which the insurer agrees to make good the loss, is known as premium.

On the other side under Islamic Insurance there are four parties involved namely the participant i.e. a person who joins the pool of persons under Islamic insurance contract by paying a specific amount in form of contribution or donation as per the requirements of takaful fund. The second party is known as operator, i.e. a person who regulates the functioning of takaful fund as on the lines of Shariah provisions. The third party is known as Insurer, i.e. a person who undertakes to make good the loss. The lastly the fourth party is known as Beneficiary i.e. a person who in case of any misfortune or uncertainty been paid out of takaful fund an amount of money to overcome such misfortune or uncertainty.

(8) Differences in Quantum of Damages

The quantum of damages in an insurance policy under common legal system are basically governed by the general principles of tort. The main objective of damages is to provide a fair estimated compensation to the victim who suffers loss, injury or damage happening to his body or property, so that the victim may be placed in a pre-injury position. There are generally two categories of damages considered for the quantum namely: “economic or pecuniary loss” and “pain and suffering” which related to non-pecuniary

11. See www.IslamicFinance.com, visited on 2/06/2012
damages. In an insurance policy, the scope of quantum of damages is limited to economic or pecuniary loss, which includes economic loss to the property insured medical expenses, future earning and also the loss of use in an accident policy and policies of a similar nature.14

Whereas quantum of damages in an insurance policy under Islamic legal system is concentrated upon sustaining mutual co-operation, solidarity and brotherhood towards material security against risk. The material security against risk is only a reasonable one. This means that the participant may only claim a reasonable amount as loss or damage incurred to the subject matter of the policy. Thus, an insurance policy under Islamic Legal System does not give the participants the hope of an unexpected gain or enrichment with unlimited damages.15

(9) Differences in Consideration (Premium)

Both Common law as well as Islamic law share the same view that there must be a valuable consideration for a valid insurance policy as without consideration insurance contract cannot be held as valid. The basic difference under both the system lies in determining the mode of the "value" that constitutes valuable consideration. Under common legal system the value is determined based on case law, statutory provisions, equity and customary practices. Whereas, under Islamic legal system, the "value" is determined on the basis of Divine Sanctions. Therefore under Islamic Legal System, if a thing is not recognized by Shariah principles as valuable (Mutaqawwim), such a thing may not be acceptable as valuable consideration in an insurance policy. For instance, the policyholder uses stolen money to settle agreed premiums, this may not be regarded as a valuable consideration as it is prohibited by Shariah principles.16

(10) Differences in Modus operandi

The modus operandi in insurance under common law is based on positive law, natural law and judicial precedents and the legality of subject matter of insurance policy is based on Indian Insurance Act of 1938, case laws etc.

The modus operandi in Islamic insurance (takaful) is based on Shariah principles and the legality of subject matter of insurance policy must be tested on the lines of Shariah principles.17

(11) Differences in Contractual Relationship

The contractual relationship of insurance under common legal system is in the form of policy document containing the risk sharing contract between insured and the assured as represented by the insurance company.

The contractual relationship under Islamic insurance (takaful) is the combination of tabarru contraction (donation) and the contractual relationship between the individual participant and the pool of participants and the takaful operator as represented by the takaful contract.18

(12) Differences in Investment of Funds

The investment of funds of insurance under common legal system can be invested in an interest based scheme and can also be invested in any scheme or project, which may not be supported by the Shariah principles.

The investment of funds under Islamic insurance (takaful) shall be invested in Shariah justified scheme and the entire procedure shall comply the guidelines of the Shariah principles and the investment returns must not be driven by any unethical commercial activities.19

17. See, Billah Ma'sum Mohd, op. cit, p. 68.
19. See Kessar Khaled, op. cit, p. 69.
The basic difference between reinsurance under common legal system and retakaful is given below:

(i) Differences in Operation

In a insurance under common legal system, the insurance company passes the premium it receives from the insured to the reinsurance company and receives a commission from the reinsurer to cover its management expenses.

In retakaful operations, such commission is not allowed as this would imply that the Takaful company is simply an agent for the reinsurer. In addition, this commission is subject to riba which is prohibited in Islam.

(ii) Differences in Dependency

Under common legal system the insurance company also receives a profit commission as a reward for careful and sound underwriting. This operation involves riba and gharar, which are not in the line with Sharia’h principles.

The retakaful operations depends on actual expenses spent by the Takaful operator in the process of retakaful.

(iii) Differences in Administration

Under common legal system there is no Sharia’h board in reinsurance companies.

Under Islamic legal system the Sharia’h board is a must in each retakaful company.

(iv) Differences in treatment of Surplus

Under common legal system the reinsurer retains a share of surplus.

Under Islamic legal system commitment of surplus distribution is done in takaful operators fund.20

20. See Kassar Khaled, op. cit., p. 135.
The tabular comparison of insurance under common legal system as well as under Islamic Legal System is been as follows.

<table>
<thead>
<tr>
<th>Basis of Difference</th>
<th>Insurance Under Common Legal System</th>
<th>Islamic Insurance (Takaful)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Origin</td>
<td>Insurance under common legal system has its birth in the primitive tribal customs of Babylon 4000-3000 BC.</td>
<td>Islamic insurance (takaful) has its birth in the ancient Arab tribal customs before 570 CE.</td>
</tr>
<tr>
<td>2. Development</td>
<td>Development of Insurance under common legal system started from the practice of the contract of Bottomry. The working of contract of Bottomry was based on the practice of Usury/interest.</td>
<td>Development of Islamic insurance (Takaful) started from the practice of doctrine of ‘al-aqilah’. The working of doctrine of ‘al-aqilah’ was based on the basis of mutual co-operation among the Arab tribes.</td>
</tr>
<tr>
<td>3. Meaning</td>
<td>Insurance under common legal system is a contract between the insurance company and the policyholder, whereby the insurance company is required to pay monetary compensation to the policyholder or beneficiary in the event of misfortune.</td>
<td>Islamic insurance (takaful) is a contract between a pool of persons and the manager of the risk pool (Takaful operator) where in they pay a certain amount of money as contribution or donation for the purpose of assisting each other in times of misfortune.</td>
</tr>
<tr>
<td>4. Sources</td>
<td>The sources of insurance under common legal system are mainly the Indian Insurance Act of 1938, judicial precedents, customs, usages as well as principles of contract and tort.</td>
<td>The sources of Islamic insurance (takaful) are Al-Quran, Hadith, Sunnah, Mutual Cooperation, Solidarity, Security and Brotherhood.</td>
</tr>
<tr>
<td>5. Nature</td>
<td>The nature of insurance under common legal system aims at commercial gain on the basis of principles of business, here the contract ties between many interests which are of different nature, hence a conflict of interest may occur.</td>
<td>The nature of Islamic insurance (takaful) aims at paving the way of brotherhood, solidarity and mutual cooperation, here the contract ties between many interest of the same nature, hence there is no conflict.</td>
</tr>
<tr>
<td>6. Parties</td>
<td>There are two parties in insurance under common legal system i.e.: 1. Insurer</td>
<td>There are four parties under Islamic insurance (takaful) i.e.: 1. Participant</td>
</tr>
</tbody>
</table>

21. See Billah Ma'sum Mohd, op. cit., p. 29.  
22. Id.  
23. See Kasser Khaled, op. cit, p. 68.  
24. See Billal Ma'sum Mohd, op. cit, p. 68.  
25. See Kasser Khaled, op. cit, p. 68.
7. Premium

| 3. Insured  
| 4. Beneficiary |

Premium is the consideration for insurance under common legal system for claims, as a means of protection given to the insured person.

Premium under Islamic insurance (takaful) is considered as donation or contribution from participants, as a means of mutual assistance among participants.

8. Ownership of Insurance Premium

The ownership of insurance premium of insurance under common legal system lies with the insurance company.

The ownership of insurance premium under Islamic insurance (takaful) lies with the participants or Waqf.

9. Contractual Relationship

The contractual relationship of insurance under common legal system is in the form of policy document containing the risk sharing contract between insured and the assured as represented by the insurance company.

The contractual relationship under Islamic insurance (takaful) is the combination of tabarru contract (donation) and the contractual relationship between the individual participant and the pool of participants and the takaful operator as represented by the takaful contract.

10. Responsibility of Claims

Responsibility of claims of insurance under common legal system lies with the insurance company absolutely.

Responsibility of claims under Islamic insurance (takaful) lies with the participants themselves.

11. Responsibility of Policyholders/Participants

Policyholders pay contribution to the pool in the form of premium paid to the insurance company.

Participants make donations (tabarru) to the scheme, as well as an element of savings in life takaful where a plan includes such a component.

12. Modus Operandi

The modus operandi in insurance under common law is based on positive law, natural law and judicial precedents and the legality of subject matter of insurance policy is based on Indian Insurance Act of 1938, case laws etc.

The modus operandi in Islamic insurance (takaful) is based on Shariah principles and the legality of subject matter of insurance policy must be on the lines of Shariah principles.

13. Essential Element

Insurable interest is an essential element of insurance under common legal system and is determined on the basis of two

Insurable interest is again an essential element of Islamic insurance (takaful) and is determined on defacto basis

26. Id
28. See Kasser Khaled, op. cit, p. 68.
30. See Billah Ma'sum Mohd, op. cit, p. 68.
<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Notes</th>
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<tbody>
<tr>
<td>14. Operational Mechanism</td>
<td>The operational mechanism of insurance under common legal system is based upon the principles of insurance laws and interest.</td>
<td>The operational mechanism of Islamic insurance (takaful) is based on al-mudarbah financing, which is interest free (i.e. sharing in profit &amp; losses).</td>
</tr>
<tr>
<td>15. Investment of Funds</td>
<td>The investment of funds of insurance under common legal system can be invested in an interest based scheme and can also be invested in any scheme or project, which may not be supported by the Shariah principles.</td>
<td>The investment of funds under Islamic insurance (takaful) shall be invested in Shariah justified scheme and the entire procedure shall comply the guidelines of the Shariah principles and the investment returns must not be driven by any unethical commercial activities.</td>
</tr>
<tr>
<td>16. Role of An Agent</td>
<td>The agent in insurance under common legal system are paid out of the paid premiums, by the policyholder.</td>
<td>The agent under Islamic insurance (takaful) share the profits of the company relying on the principles of al-mudarbah.</td>
</tr>
<tr>
<td>17. Forfeiture</td>
<td>The paid premiums of the policyholders may sometimes be forfeited, especially for the breach of principle of utmost good faith.</td>
<td>The paid premiums of the participants can for no reason be forfeited, even for a breach of principle of utmost good faith or any other offence or wrong committed by the participant.</td>
</tr>
<tr>
<td>18. Bonus</td>
<td>The insurance company may offer bonus or profit in general terms only especially with profit policies, there is no exact specification with regard to the profit sharing in the contract.</td>
<td>The bonus under Islamic insurance (takaful) is based on the principle of al-mudarbah, the ratio could be 5:5 or 6:4 or 7:3 as agreed between the participant and the operator.</td>
</tr>
<tr>
<td>19. Liability of the Operator</td>
<td>Insurer is liable to pay claims according to the policy using the underwriting fund and, if necessary shareholder’s fund.</td>
<td>Takaful operator acts as the administrator of the scheme and pays the takaful benefits from the takaful (underwriting fund).</td>
</tr>
<tr>
<td>20. Access to Capital</td>
<td>Access to share capital and debt with possible use of subordinated debt.</td>
<td>Access to share capital by takaful operator but not to debt, except for interest free loan from operator to underwriting fund.</td>
</tr>
<tr>
<td>21. Profit/Surplus</td>
<td>Profit is attributable to the</td>
<td>Profit is not the objective of the</td>
</tr>
</tbody>
</table>
22. Losses

Losses are charged to the insurance company alone.

Losses are retained within classes of business written and charged to participants.\(^{39}\)

23. Nomination

The nominee in a insurance policy has an absolute insurable interest over the policy.

The nominee in a insurance policy is a mere trustee.\(^{40}\)

24. Indemnity

The claim for indemnity may be up to the amount mentioned in the insurance policy.

The claim for indemnity need not necessarily be up to the amount named in the policy but it could extend for the amount of the risk to the subject matter.\(^{41}\)

25. Law and Regulatory Framework

Indian Insurance Act of 1938

Sources of law are based upon Divine revelations (Holy Quran and Hadith), Shariah justified statutory provisions and juristic opinions (Fatwas) and local loans.

26. Moral Guidelines

Insurer invests premiums consistent with profit motive with few moral guidelines; hence coexistence of riba & maysir.

Takaful invests premium in accordance with Islamic values and Shariah guidelines.\(^{42}\)

<table>
<thead>
<tr>
<th>Basis of Difference</th>
<th>Re-insurance</th>
<th>Re-takaful</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Principle of Working</td>
<td>Under Common law system of re-insurances companies do not take into consideration the legitimacy and illegitimacy of dealing or doing business because they practice commercial insurance with the main motto of earning profits.</td>
<td>Under Islamic system of re-insurance (Re-takaful) companies take into consideration the legitimacy and illegitimacy of dealing as they are committed to the lawful Islamic rules and regulations as Shariah laws. It therefore practices re-insurance according to Islamic principles.</td>
</tr>
<tr>
<td>2. Role of Operator (company)</td>
<td>Common law insurance companies are originally considered as a party in the re-insurance contract. They practice re-insurance on behalf of themselves in order to handle risks.</td>
<td>Islamic insurance companies, on the other hand conclude the re-insurance contract as agents for the subscribers in the co-operative insurance.</td>
</tr>
</tbody>
</table>

39. See Kessar Khaled, op. cit, p. 68.
40. See Billah, Ma’sum Mohd, op. cit, p. 235.
41. Ibid, p. 284.
42. See Kessar Khaled, op. cit, p. 68.
aggravated, self-threatening risks. They are obliged by the insurance contract to pay compensation when the insured risk occurs. The insured party only has to pay the insurance premium according to the contract.

Because they manage and have a feel for insurance operations, they realize that the insurance premiums collected from the subscribers in the insurance will not be enough to pay compensation for the insured risks when the risk occurs. Therefore another entity is needed to provide protection and coverage for subscribers in Islamic insurance in order to overcome grave risks which threaten them. This entity is the re-insurance company.

3. Reserve

Under Common law insurance companies keep reserve amount from the re-insurance companies portion and invest them using usury.

Islamic insurance companies, keep the reserve amounts from the reinsurance companies portion at the Islamic company as a deposit or invest them according to Mudharaba contract and in lawful Islamic ways. The insurance company is the Mudarib (partner) and the re-insurance company is the capital owner.

4. Supervisory Body

Under common law insurance companies pays the amount as compensation for damages or as re-insurance profit commissions as well as profits are not subjected to a Shariah supervisory Board.

Islamic insurance companies take into consideration the opinion of Shariah supervisory Board in its ownership and expenditure of money.