THE CHARTERED INSURANCE INSTITUTE

590

Advanced Diploma in Insurance

Unit 590 – Principles of Takaful

October 2011 Examination Guide

SPECIAL NOTICES

Candidates entered for the April 2012 examination should study this examination guide carefully in order to prepare themselves for the examination.

Practice in answering the questions is highly desirable and should be considered a critical part of a properly planned programme of examination preparation.

590 – Principles of Takaful

Contents

Published March 2012

Telephone: 020 8989 8464
Fax: 020 8530 3052
Email: customer.serv@cii.co.uk

IMPORTANT GUIDANCE FOR CANDIDATES

Introduction

The purpose of this Examination Guide is to help you understand how examiners seek to assess the knowledge and skill of candidates. You can then use this understanding to help you demonstrate to the Examiners that you meet the required levels of knowledge and skill to merit a pass in this unit. During your preparation for the examination it should be your aim not only to ensure that you are technically able to answer the questions but also that you can do justice to your abilities under examination conditions.

Before the examination

Read the Advanced Diploma in Insurance information for candidates and important notes for candidates

Details of administrative arrangements and the regulations which form the basis of your examination entry are to be found in the current Advanced Diploma in Insurance Information for Candidates and important notes for candidates, which is *essential reading* for all candidates. It is available online at www.cii.co.uk or from Customer Service.

Study the syllabus carefully

It is crucial that you study the relevant syllabus carefully, which is available online at www.cii.co.uk or from Customer Service. All the questions in the examination are based directly on the syllabus. *You will be tested on the syllabus alone,* so it is vital that you are familiar with it.

Read widely

It is important to study the syllabus, which is available online at www.cii.co.uk or from Customer Service. The questions in the examination paper are based directly on the syllabus, so it is vital that you are familiar with it.

Make full use of the Examination Guide

The best way to understand what the examiners require is to study the CII Examination Guides. You can purchase copies of Examination Guides online at www.cii.co.uk. CII members can download free copies of past Examination Guides online at www.cii.co.uk/knowledge. This guide and previous Examination Guides can be treated as ‘mock’ examination papers, attempting them under examination conditions as far as possible and then comparing your answers to the model ones. The examiner’s comments on candidates’ actual performance in each question should be noted carefully.

Understand the nature of assessment

Assessment is by means of a three-hour written paper. This Examination Guide contains a full examination paper and model answers. The model answers show the types of responses the examiners are looking for and which would achieve maximum marks. *However, you should note that there are alternative answers to some question parts which would also gain high marks.* For the sake of clarity and brevity not all of these alternative answers are shown.

Know the structure of the examination

Familiarise yourself with the structure of the examination paper and the time allowed to complete it. This information can be found on the question paper included within each Examination Guide.

In the examination

Assuming you have prepared adequately, you will only do justice to yourself in the examination if you follow two crucial common sense rules:

1. **Spend your time in accordance with the allocation of marks as indicated on the paper.** The maximum marks allocated to each question and its constituent parts are given on the paper; the number of marks allocated is the best indication of how much time you should spend on each question. If a question has just two marks allocated, there are likely to be only one or two points for which the examiner is looking, so a long answer is a waste of time. Conversely, if a question has 12 marks allocated, a couple of lines will not be an adequate answer. Always remember that if the paper is not completed, your chances of passing will be reduced considerably. Do not spend excessive time on any one question; if the time allocation for that question has been used up, leave some space, go on to the next question and only return to the incomplete question after you have completed the rest of the paper, if you have time.

2. **Take great care to answer the precise question set.** The model answers provided in this Examination Guide are quite focused and precise; alternative answers will only be acceptable if they still answer the question. *However brilliantly a candidate writes on a particular topic, if it does not provide a satisfactory answer to the precise question as set, the candidate will not achieve the marks allocated.* Many candidates leave the examination room confident that they have written a 'good' paper, only to be mystified when they receive a disappointing result. Often, the explanation for this lies in a failure to think carefully about what the examiner requires before putting pen to paper.

Order of tackling questions
Tackle the questions in whatever order feels most comfortable. Generally, it is better to leave any questions which are felt to be very challenging until the more familiar questions have been attempted, but *remember not to spend excessive time on the questions you are most confident about.*

Answering different question parts
Always read all parts of a question before starting to answer it, otherwise, you may find that after answering part (a), the answer you have given is really more appropriate to part (b) and it would be necessary to duplicate much of what has already been written. The examiners will normally only give credit for an answer if it is contained within its correct question part.

Handwriting
Provided handwriting is legible, candidates will **not** lose marks if it is 'untidy'. *It is strongly recommended that candidates do not write in block capitals,* because they will be slowed down so much by doing so.

Answer format
Unless the question requires you to produce an answer in a particular format, such as a letter or a report, *you should use 'bullet points' or short paragraphs,* since this allows you to communicate your thoughts in the most effective way in the least time. The model answers indicate what is acceptable for the different types of question.

Calculators
If you bring a calculator into the examination room, it must be a silent battery or solar-powered **non-programmable** calculator. The use of electronic equipment capable of being programmed to hold alphabetical or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements. *It is important to show all the steps of your calculation in your answer.* The examination is testing your ability to carry out all the appropriate steps in calculating a value. A proficient mathematician is someone who follows the correct method, i.e. carries out the appropriate steps. The majority of the marks will be allocated for demonstrating the correct method of calculation.

After the examination

All examiners who mark Advanced Diploma in Insurance answer books are either active practitioners in the financial services industry or are experts on the subject. They have been specially trained to mark papers using a detailed marking scheme, the model answers in examination guides are based on those marking schemes.

After each examiner has provisionally marked a small number of answer books, there is a co-ordination meeting of all the examiners at which the Senior Examiner goes through the marking scheme with the other examiners. Based on the feedback from the initial marking, the detailed marking scheme is finalised.

The marking of each examiner is closely monitored by a Senior Examiner during the marking period and sampling of marked answer books is carried out.

After all the answer books have been marked, a moderation meeting is held, at which all available statistical information is considered, together with the views of the Senior Examiner and other assessment experts. At the meeting a pass mark is set which should ensure that the standard of knowledge and skills required to pass the paper is comparable with that of previous papers. All candidates at or above the agreed pass mark will pass: the CII does not operate a quota system whereby only a fixed percentage of candidates can pass a paper.

EXAMINERS' COMMENTS

The standard of the papers, in general, was fair. But as we have seen on previous examination sessions, there were some excellent scripts with detailed and well thought out answers which demonstrates a high level and a deep understanding of the topics questioned, that shows the time candidates have committed to exam preparation.

Where it was clear that candidates had not prepared for the exam, candidates did not gain all of the available marks, as they did not provide the level of detail or deep discussion required. Another general error was that some candidate's did not address all issues in the question.

As such, in this session many candidates did not achieve high marks with quite a few candidates achieving less than half of the available possible marks.

Question 1

The majority of candidates knew the answer to this question but answered more on part (a) uninsurable risk than part (b) typical investment channel.

Question 2

This question was answered well by many candidates. Those who gained low or no marks seemed to perform the same throughout the exam.

Question 3

Many of the candidates did not perform well in this question, very few were able to fully compare mutual insurers with assessment mutual's.

Question 4

Many of the candidates did not answer this question well, with a few not even attempting it. A common error was candidates not fully addressing the four features of contracts in Shariah.

Question 5

Candidates demonstrated an overall understanding of how deficit is treated, but many were not able to fully address the guidelines of deficit treatment within participants' fund in a Takaful organisation.

Question 6

The majority of candidates were able to list most of the six marketing characteristics of insurance.

Question 7

This question had somewhat mixed results with varied marks being achieved. Most candidates were either able to list all or most of the six main values of cooperatives or not able to provide any.

Question 8

This question was not well answered by the majority of candidates. The majority discussed risk management in general without addressing how Takaful operates.

Question 9

Many of the candidates were able to prepare financial statement of policyholders' revenue and expenses for a Takaful company. However, quite a few candidates did not provide a detailed enough answer on the second part of the question, which related to the three different methods that could be used to distribute surplus.

Question 10

Almost all candidates attempted this question, with the majority demonstrating a good understanding of Riba, Gharar, Ghabn and Jahala. However quite a few candidates were not able to discuss the four concepts in the depth required to gain all of the available marks.

Question 11

Most candidates who attempted this question answered quite satisfactorily, although none were able to fully address all the governance issues and rights of Takaful policyholders in the depth and detail required.

Question 12

The majority of candidates attempted this question. Most of those who attempted the question demonstrated a good understanding of the differences and similarities between Takaful insurance and conventional insurance. Only few candidates of those who attempted the question did not perform well.

Question 13

This question, which was attempted by many candidates, produced mixed result. Quite few of the candidates demonstrated a fairly good understanding of how Islam view profits in conventional commercial insurance as exploitative in nature, and how moral hazards can contribute to exploitative profits, and how Takaful can offer relevant alternatives, but were not able to discuss it in the depth required, and so were not able to gain all of the marks paraphrase available.

Question 14

This question gave a mixed result of answers. The majority of candidates who attempted the question were able to answer the question fairly well, but many candidates did not discuss in the depth required the Shariah rules governing the Wakala in the Islamic Law Contracts to gain good marks.

THE CHARTERED INSURANCE INSTITUTE

590

Advanced Diploma in Insurance

Unit 590 – Principles of Takaful

October 2011 examination

Instructions

- Three hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and form B.
- You are allowed to write on the inside pages of this question paper, but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- The answer book and this question paper must **both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future.**

Unit 590 – Principles of Takaful

Instructions to candidates

Read the instructions below before answering any questions

- **Three hours** are allowed for this paper which carries a total of 200 marks as follows.

Part I	8 compulsory questions	48 marks
Part II	1 compulsory question	38 marks
Part III	3 questions selected from 5	114 marks

- You should answer **all** questions in Part I, the compulsory question in Part II and three out of the five questions in Part III. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.
- You are advised to spend no more than 45 minutes on Part I.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.
- It is important to show all steps in a calculation, even if you have used a calculator.
- If you bring a calculator into the examination room, it must be a silent battery or solar-powered non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.
- Answer each question on a new page and leave six lines blank after each question part.

PART I

Answer ALL questions in Part I.
Each question is worth six marks.

Note form is acceptable where this conveys all the necessary information.

1. **(a)** Describe **three** conditions that would identify a risk as uninsurable. **(3)**

(b) Outline **three** typical investment channels that an Islamic insurance company would pursue. **(3)**

2. State **six** types of risks that a Takaful insurance company cannot accept. **(6)**

3. Describe the difference between mutual insurers and assessment mutuals. **(6)**

4. Describe the **four** basic features of contracts in Shariah. **(6)**

5. State the basic guidelines, and outline the options available to shareholders, in the treatment of a deficit within the Participants' Fund in a Takaful organisation. **(6)**

6. List **six** marketing characteristics of Insurance. **(6)**

7. List **six** main values of co–operatives. **(6)**

8. Describe the form of risk management that Takaful operates. **(6)**

Part II

Compulsory question
This question is worth 38 marks

9. **(a)** ABC Islamic Insurance Company is based in Bahrain. As per the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) financial accounting standards, ABC Islamic Insurance Company is due to prepare the company's set of financial statements for 2011.

Identify and prepare, **showing all your workings**, the ABC Islamic Insurance Company financial statement of policyholders' revenue and expenses for the year 2011. **(26)**

Item	**Debit (BHD)**	**Credit (BHD)**
Gross contributions		600,000
Acquisition Cost	60,000	
Remuneration of ABC for managing insurance operations		150,000
Total policyholders' investment income		4,000
Reinsurers share of contributions	420,000	
Reinsurance Commissions		126,000
Paid Claims	40,000	
Unearned contributions	80,000	
Recovered claims from reinsurers	30,400	
ABC share for managing investments		400
Outstanding claims-end of period	80,000	
Recoverable outstanding claims from re-insurers		60,000

(b) Describe **three** different methods that could be used to distribute surplus. **(12)**

Questions continue over the page

Part III

Answer THREE of the following FIVE questions
Each question is worth 38 marks

10. In the context of Shariah and Islamic contracts, define and evaluate the following:

- Riba;
- Gharar;
- Ghabn;
- Jahala. **(38)**

11. Explain, in detail, the governance issues and rights of Takaful policyholders. **(38)**

12. Compare Takaful insurance and conventional insurance. **(38)**

13. Evaluate how Islam views profits in conventional commercial insurance as exploitative in nature. In your answer, you must describe how moral hazards can contribute to exploitative profits and how Takaful can offer a relevant alternative. **(38)**

14. Analyse the Shariah rules governing the Wakala Contract in the Islamic Law of Contracts. **(38)**

NOTE ON MODEL ANSWERS
The model answers given are those which would achieve maximum marks. However, there are alternative answers to some question parts which would also gain high marks. For the sake of clarity and brevity not all of these alternative answers are shown. An oblique (/) indicates an equally acceptable alternative answer.

Model answer for Question 1

(a) *Candidates would have gained full marks for any three of the following:*
- No monetary value.
- No insurable interest (as required by law).
- Illegal or unlawful activity.
- Vice or dishonest behaviour contributing to the risk (i.e. fraud).
- Certain catastrophic risks such as nuclear accident, famine or war.
- Public policy exclusions such as fines or criminal acts.
- Usual wear and tear and depreciation of property.
- Other factors or limitations that contribute to making a risk insurable are delay, vermin, market agreements, government confiscation or authority etc.

(b) *Candidates would have gained full marks for any three of the following:*
- Real estate investment.
- Direct investment in all Halal commercial and industrial activities.
- Profit sharing (Mudaraba), trusts, deposit with Islamic banks.
- Skuk.
- Any other Islamic funds or transactions which are interest-free activities.

Model answer for Question 2

All the following are not allowed to be covered by an Islamic insurance company:
- Alcohol and drugs based products and activities.
- Prostitution.
- Haram (prohibited) products.
- Any transaction involving Riba.
- Any transaction involving Gharar.
- Any transaction involving Miser.

Model answer for Question 3

Mutual Insurers are typically for-profit organisations that are co-owned and operated by the policyholders, underwriting general insurances. Any profits (or resultant losses), are shared collectively by the policyholders.

Assessment Mutuals are usually smaller than Mutual Insurers. Assessment Mutuals specialise in coverage of agricultural properties, underwriting 'assessable policies'. Such policies collect only minimal advance fees to cover operating expenses with additional amounts being assessed when needed.

Model answer for Question 4

An Islamic contract requires the existence of the following elements:
- Ijab/offer which means making a positive proposition by one party in a transaction.
- Qabul (Acceptance) which is the response to the offer by the other party showing approval of the proposition.
- Ahliyyat al-'adaa (active legal capacity) which means that the persons (or their agents) who attend the contract session must enjoy active legal capacity by Sharia measures.
- Sharia Permissibility; the subject matter of the contract, and its terms or conditions must be well defined and permissible by Sharia. The contract should not explicitly or implicitly, directly or indirectly contain any practices, that are not permissible by Sharia.

Model answer for Question 5

The shareholders will provide the money needed to finance the deficit and they may collect the repayment of their money either through:

- an interest free loan Qard Hasan;
- increasing the premiums (contributions) in the next year(s);
- using the next year(s) surplus (if any).

The contract between the shareholders and the Participants' Fund to finance the deficit by giving Qard Hasan, is called a Kafalah (Sponsorship) contract.

The method of handling the surplus and deficit must be stated in the insurance policy at the inception of the contract.

Model answer for Question 6

Candidates would have gained full marks for any six of the following:

- Intangibility.
- Transience (Except long-term business).
- Inconsistent specifications.
- Regulation.
- Personal Interaction.
- Staff quality is critical.
- No physical distribution channels.

Model answer for Question 7

Candidates would have gained full marks for any six of the following:

- Self-help.
- Self-responsibility.
- Democracy.
- Equality.
- Equity.
- Solidarity.
- Honesty.
- Openness.
- Social Responsibility.
- Caring for other.

Model answer for Question 8

- Takaful is a form of co-operative risk sharing using charitable donations.
- The policyholders, or insured, pay a premium to a fund as a donation for those who suffer losses.
- The policy holders are then entitled to receive a surplus from the co-operative insurance fund, just as they will help make up for any deficits. The premium or donation will differ, based on the degree of risk.

Model answer for Question 9

(a) Insurance Company Statement of Policyholders' Revenues and Expenses for the year 2009

	(£)
Insurance Revenues	
Gross Contributions	600,000
Less: Reinsurers' Share	(420,000)
Net Retained Contributions	180,000
Less: Changes in unearned contributions	(80,000)
Earned Contributions	100,000
Reinsurance Commissions	126,000
Total Insurance Revenue	226,000
Insurance Expenses	
Paid Claims	40,000
Recovered claims from reinsurers	(30,400)
Net Paid Claims	9,600
Outstanding Claims-end of year	80,000
Less: Recoverable Outstanding Claims from reinsurers	(60,000)
Net Outstanding Claims	20,000
Remuneration of company for Managing insurance operations	150,000
Acquisition Cost	60,000
Total Insurance Expenses	239,600
Net Loss from Insurance Operations	(13,600)
Investment Income	
Investment Income	4,000
Less: Owners equity share for Managing investment portfolio	(400)
Net Investment Income	3,600
Loss of Revenue over Expenses	(10,000)

(b) Surplus treatment methods:

Distribution of the surplus to all policyholders
Under this method all policyholders are entitled to get a proportion of the surplus, if any, whether they made claims during the financial year or not.
Therefore if:

- SR: Surplus (Total for the fund)
- GPW: Gross premium written (Total for the fund)
- GPWr: Gross premium written (Total for the policyholder, r)
- Then the surplus due to the policyholder, r = (Sr)
- Sr = (GPWr/GPW) x S

Distribution of the surplus to only policyholders with no claims
This method only allows surplus to the policyholders who did not make any claims during the financial year in question. In this case the abovementioned equation can be used only for the policyholders who did not make claims during the financial year. GPW will be the total premium written, minus the total premium of policyholders who received claims compensation from the insurance company.

Distribution of the surplus to all policyholders based on the net result of each policyholder
This method mixes the rationale of the two previous methods. It allows all policyholders to share the surplus proportionally, based on the underwriting result of each of the policyholders (premiums-claims).

For this case the previous equation must be amended as follows:

- Sr = [(GPWr – {C+R}) / (GPW – TC)] x S
- Where C: Claims paid to policyholder (r)
- R: Reserves belonging to the policyholder's (r) business
- TC: Total Claims Paid

Model answer for Question 10

The word Riba, in Arabic language, literally means an 'increment' or 'addition'. In Islamic Fiqh the term Riba is equivalent to interest; Riba is an unjustified increment in borrowing or lending money, paid in kind or in money above the amount of loan, as a condition imposed by the lender or voluntarily by the borrower. Riba defined in this way is called in Fiqh 'riba al-duyun' (debt usury). Accordingly, interest in any type is Riba.

To emphasize interest or Riba prohibition reference should be made to three Fiqh rules;

- A benefit gained from a loan is Riba a rule which is based on the ethics of Qard Al-Hassan (Benevolent or good loan) in Quran. And in Hadith of the Prophet (Pbuh) 'the only reward for a loan is the thanks giving (i.e. to lender) and the repayment'.

- ('A Return versus a Guarantee') which means that the capital owner has to choose either a 'return' on his capital by sharing profit or loss, or a 'guarantee' that his principal will be paid back intact. In the first case the capital owner is playing the role of investor and in the second he is a lender. An investor can not be a lender at the same time, or in other words a 'return' cannot accompany a 'guarantee' on capital. If a combination is allowed the return obtained on capital is Riba.

- 'If gain is desirable loss also should be acceptable' which means that the capital owner will be entitled to 'Profit' provided that he is ready to accept 'loss' if this happened.

Gharar means hazard or risk. Most Fiqh scholars define Gharar as a combination of the unknown and the doubtful. Gharar exists in contracts when the subject matter of exchange concerns probable items whose existence or characteristics are doubtful or not certain. For example Gharar exists in any sale, or deal that lacks fixation, or proper fixation, of price, quantity, quality or delivery date or time.

Gharar can result from accepting speculative risk. In business rational behaviour requires risk aversion. Thus if risk or hazard, is deliberately ventured in any deal it changes its nature and makes it akin to gambling, which is forbidden in Islam.

In conventional insurance contracts involves agreements on matters that may or may not happen and the insured person pays for buying the insurance policy in any way. If the person is subject to misfortune or the event that deserves getting indemnification the insurance company pays otherwise it gains whatever paid by the insured (akin to gambling).

Ghabn, in general, is injustice. In transactions it results from fraud or deception committed deliberately by one party of an exchange in a manner that would unjustifiably lead to improper underestimation or overestimation of the value of the subject matter of that exchange (a commodity or a service). Ghabn can therefore be defined as fraud or deception that would unfairly harm the interests of one party of an exchange to the benefit of the other party.

In insurance contracts, as in all other contracts, information concerning the subject matter of the service should be stated in clear cut manner to the contract's parties in order to avoid Ghabn. It can be said that Ghabn is unlikely to exist when full, and perfect information are available to everyone. In insurance business companies face 'moral hazard', i.e. risk linked with uncertainty of the information delivered by the insured.

Within frame of Islamic Sharia and ethical values, A true Muslim, when concluding a contract, knows that if any information is hidden with deliberate purpose to unduly benefit from the other party Ghabn is committed. Ghabn is not only a sin but it also might entirely invalidate the contract.

To explain, Ghabn is divided by fuqaha into two kinds; minor and major Ghabn. Minor Ghabn, is a slight one and it would happen when the value of transaction is insignificantly fixed in favour of one party of the concerned exchange.

Major Ghabn, that is a large one that takes place when the value of the concerned transaction is excessively fixed in favour of one party, which unfairly harms the other party and unduly inflicts loss upon him. It is major Ghabn which would surely invalidate a contract or renders compensation necessary.

Literally, Jahalah means ignorance. In contracts it means loss or absence or serious imperfection of information concerning the subject matter of the agreement or its terms. It renders the contract void.

It should be noticed that ignorance is directly or indirectly an important source of Gharar and Ghabn. Elimination of Jahalah means that parties of the contract have to be aware of all conditions and obligations that it includes. In modern Islamic companies when contracts are readily pre-repaired and printed in standard forms, a person who is willing to join the company should read and understand all details of the contract, which must be clear, transparent and set within Sharia boundary.

The standard contract is in fact ‘an offer’ presented by the business entity and once it is signed it means that this offer has received ‘acceptance’. From this moment the contract becomes effective and mandatory to both parties and the person who joined the company by signing the contract cannot claim ignorance of his (her) obligations.

Model answer for Question 11

Typically, in mutual insurers (similar to Takafuls) policyholders have rights that divide into three categories:

Membership Rights
- Covers the legal and ownership rights of policyholders as a member of the mutual.
- While not identical to ‘ownership’ rights of shareholders of a stock insurers because there is no control over property;
- a mutual member does have a shared right to excess surplus;
- and may have a claim against assets of a mutual in bankruptcy or dissolution.

Contractual rights
- Covers the express benefits and obligations under the policy contract which is binding upon the member/policyholder.
- Technically, the member shares in the mutual risk pool only and should have no claim against the Takaful Operator’s shareholder capital nor related investments.

Governance rights
- Covers governance of the entire organization.
- Mutual policyholders should have a voice in how an entity is managed, how the records and books are kept as well as open access to financial accounts;
- and ideally in selection of a board of directors.
- In similar fashion, it is common sense that a Takaful is operated for the chief benefit of policyholders, and yet very few Takaful Operators globally have a mechanism whereby representation by members is included on the board level. Many conventional mutuals enable members to exercise governance rights pertaining to fundamental “corporate” transactions such as mergers, acquisitions, or sale of substantial portions of mutual assets.
- If Takaful enterprises are to truly differentiate themselves from conventional insurance companies, including mutual insurers, they must eventually address these members’ rights;
- and actively encourage the empowerment of a customer base with possibly additional benefits accruing including stronger loyalty.

Model answer for Question 12

Insurance Contract

Conventional
- Risk transfer mechanism.
- Risk is transferred from insured to specialized party (insurance company).

Islamic
- Risk sharing mechanism.
- Mutuality and Participant responsibility.

Economic Objectives
- Conventional – Profit maximisation for the benefits of shareholders.
- Islamic – mutual interest/joint guarantees.

Insurance Company role
- Conventional – insurer.
- Islamic – Operator (portfolio manager).

Law
- Conventional – secular regulations.
- Islamic – Shariah regulations.

Ethical framework
- Conventional – Codes of conducts for business purposes to maximum long term value of shareholders funds.
- Islamic – Islamic business ethics of social responsibility.

Contract forms
- Conventional – Commercial insurance contract (Bilateral contact).
- Islamic – Cooperative (unilateral contact) Plus Islamic contracts of Wakala/Mudaraba/Kafala.

Underwriting policy
- Conventional – Insurability/Profit making/Underwriting technique.
- Islamic – Sharia framework (Haram business is restricted)/Insurability/Underwriting techniques.

Investment
- Conventional – Equity/debt-no restrictions.
- Islamic – Interest-free Shariah-compliant investments.

Surplus
- Conventional – shareholder’s account.
- Islamic – Participants account or sharing system.

Model answer for Question 13

Insurance companies would always be subject to 'moral hazard' which companies face with 'asymmetric information', i.e. customers not giving full or accurate information about themselves or their cases when buying their insurance policies. This is just a minor example of why an insurance company would pursue exploitative profits for purposes other than maximising the shareholders' interests. The problem of asymmetric information would be minimized or eliminated when the owners of the company are themselves those insured.

Islam has strong objections to adopting unethical methods for achieving profits. The question of ethics here is judged by Sharia. Hence it is objectionable to make a profit from any business, trade, or activity that is prohibited (haram).

For example, according to the Quran, it is not permissible to make profit out of wine (i.e. alcoholic drinks or drugs), pork and meat or poultry that are not compliant with the rules of Sharia. In Sunnah (the Prophet's traditions) it is not allowed to make profit out of lending money, prostitution, or by claiming that you can foretell a person's future.

It is also prohibited to make profit by raising prices in a monopolistic manner, by fraud, or by exploiting the unhappy events or circumstances that force the seller to accept unrealistic or unfair price.

Islamic business ethics also motivates people to be tolerant in their transactions and urges lenders to be merciful and patient in getting back their interest-free loans from borrowers. In general profits within Islamic ethics should be clean, non exploitative and always linked with real productive efforts.

On these ethical bases Islam objects to the exploitative nature of profits that are achieved by selling the insurance service. Islam does not exclude services from productive activities and restricts real production only to material products. Islam recognized the real productive nature of a wide range of services such as teaching, leasing houses or providing means to carry people or goods, or guarding houses or business etc.

With respect to conventional commercial insurance, the company would be realizing its underwriting profit by selling insurance policies for premiums paid those insured and its investment profit on the other hand by investing its financial resources. The company owners, who are the shareholders, are a separate entity from the insured persons.

The company would be able to fairly estimate, through available relevant information, financial losses or accidents that will most probably take place as a percentage of the total number of the insured group. The amount of the premium is determined by the operation of the law of averages as calculated by actuaries. Within this frame the company's job is to manage risk for all operations with the main target of maximizing its profit.

Insurance expertise is basically used in estimating probabilities of accidents and people's misfortune and in terms of actuarial calculations needed to maximize their profits. As such profits here resemble those realized by business involved in modern gambling. Commercial insurance though is not typically gambling but is almost dependent on gambling rules for realizing abnormal profits.

Islamic Sharia forbids gambling (Maiser) and is definitely against any kind of business that relies on practices that are similar to gambling or involves doubts that gambling is involved. Islamic Sharia also prohibits any practices that may lead to what is prohibited.

Thus under commercial insurance the rational motive of individuals to take care of their future life and protect their economic interests is exploited for sake of profit making. The principal factor that is needed for a successful production of the insurance service, which is social co-operation, is exploited for the sake of making commercial profit.

The moral values that are often mentioned to defend insurance on the basis of co-operation have been lost because a group of people, the share holders who own the insurance company are benefiting at the expense of all the others who seek the insurance service. Exploitation of this sort while it intensifies in a monopolistic insurance market would be relatively reduced in a competitive insurance market. Yet, it can never be eliminated unless the insurance company and the insured persons become one entity.

Model answer for Question 14

- The subject matter of agency should be known and clearly defined, specified with full transparency in the contract. This is to avoid uncertainty or Gharar.
- The act for which an agent is authorised should be Sharia permissible and agency is not allowed in any haram transaction or earnings.
- Wakeel (Agent) receives his commission upon performance of the job which he is authorized to do. Wakeel (agent) is not an employee who is entitled to wage or salary on regular bases irrespective of conditions of the transaction(s) that are run by means of Wakala.
- The Wakala contract can be made only for a certain known transaction. This is called ‘Particular Wakala’. On the other hand ‘General Wakala’ means that there is a general delegation of power from the principal to the agent. Wakala may also be restricted by specific conditions in the contract. In this case the agent has to strictly observe these conditions.
- Regardless of the amount, or scope, of authority given to the Agent, the Agent represents the Principal and is subject to the Principal’s orders and control. Accordingly the Principal is liable for the consequences of acts that the Agent has been directed to perform. In case of restricted Wakala the principal will however not be held liable for the consequences of the Agent’s transactions if this has not observed conditions imposed on his actions.
- An Agent cannot delegate another person for the subject matter and responsibility of his Wakala, unless he or she is permitted to do this by the Principal in the original contract.
- The Agent cannot be held responsible for loss or damage of part or whole of the subject matter of Wakala (goods, assets, or money) because an agent in Sharia is a trustee and not a guarantor. The Agent is only liable for such loss or damage if proved that he or she was negligent, or acted in agency in an irresponsible manner.
- The agency relationship requires the agent to use reasonable care to serve and protect the interests of the Principal. Thus the Agent when carrying an investment or trade for the Principal has to seek the best investment opportunities, best possible market values in trade, secured deals, and best modes of payment.
- An agent who acts in a manner that harms the Principal’s interest or turns benefits that accrues from agency to be in his or her own interest violates the Wakala ’s basic Sharia responsibilities, and will be financially liable to the Principal for any losses incurred thereupon.
- The Principal (Muwakil) and the agent (Wakeel) have equal rights to withdraw from a Wakala agreement by giving agreed upon notice. If there is no notice clause in the agreement, Wakala can be terminated at any time.