



## Shariah Rulings and Standards for the Foundations of Cooperative Insurance

📅 22 November, 2013 | Cooperative Insurance, Insurance Provisions

In the Name of Allāh,

the Entirely Merciful, the Especially Merciful

Praise is due to Allāh, Lord of the worlds, may the blessings and peace be upon our master Muḥammad, the last of prophets, on his family, and all his companions.

**Resolution No. 200 (6/21)**

## Shariah Rulings and Standards for the Foundations of Cooperative Insurance

The Council of the International Islamic Fiqh Academy of the Organization of Islamic Cooperation, holding its 21st session in Riyadh, Kingdom of Saudi Arabia, on 15-19 Muḥarram 1435h (19-22 November 2013),

Having reviewed the recommendations of the scientific seminar on *Shariah Rulings and Standards for the Foundations of Cooperative Insurance*, organized by the Academy in Jeddah, Kingdom of Saudi Arabia, on 20-21 Jumādā al-Ākhirah 1434h (30 April - 1 May 2013) in response to Academy resolution no. 187 (2/20), issued at its 20th Session in Oran, People's Democratic Republic of Algeria, on 26 Shawwāl - 2 Dhū al-Qi'dah 1433h (13-18 September 2012),

Having listened to the in-depth discussions on the subject,

### Resolves

Cooperative insurance is a new contract based on the principle of cooperation which, in its turn, is governed by criteria and standards derived from the guidance of the Quran and Sunnah (Prophetic Tradition).

Insurance, in general, is divisible into two types:

1. Commercial insurance aims to achieve gain to insurance holders through compensation for risks, while from the standpoint of the managing company, it aims to achieve
2. Non-commercial insurance does not aim to achieve profit but to serve the interest of its participants through mutual contribution to the bearing of

The second type of insurance has several denotations, including cooperative insurance, takaful insurance, reciprocal insurance and Islamic insurance.

There are essential differences between cooperative insurance and commercial insurance of which most important are the following:

1. Islamic cooperative insurance is a form of cooperation between members of a group or several groups in the society through mutual contribution



to risk-bearing without seeking profit. Therefore, it does not constitute a muawada (compensation) contract, and the degree of *gharar* (uncertainty) it involves is forgivable. Contrarily, commercial insurance is a muawada (compensation) contract that aims to generate profit through compensation for shifting risks from insurance clients to insurance companies. Therefore, commercial insurance is subject to the rulings on compensatory financial dealings that are affected by *gharar*.

2. The parties of the relationship in cooperative insurance are the total number of participants in the cooperative insurance fund and the managing party, while in commercial insurance, they are the company and the
3. In cooperative insurance, there is a fund containing assets that comprise policyholders' contributions, profits generated from investment of contributions, and reserves, whereas there is no such fund in commercial
4. In cooperative insurance, the management company assumes the task of managing the coverage and insurance business, besides investment of insurance funds. In contrast, in commercial insurance, the insurance company is the insurer who owns the insurance premiums, insurance profits and surplus.
5. Policyholder and insurer in cooperative insurance are the same person with two different legal considerations, contrary to commercial insurance, where they are entirely different entities since the participant is the insurance client and the insurer is the insurance company.
6. Management in cooperative insurance, whether an elected body from the participants, a specialized company or public institution, is an agent that assumes contracting on behalf of participants' (policyholders) fund and has the right of receiving payment for that, while in commercial insurance management is a principal party who performs contracting on its
7. The managing company in cooperative insurance does not own the insurance premiums (contributions) because premiums are owned by participants' (policyholders) fund, but in commercial insurance, the company owns the insurance premiums against its commitment to provide compensation in case of injury.
8. In cooperative insurance, the remainders of the premiums and their returns - after deduction of expenses and compensations - remains owned



by and in the fund accounts. It constitutes the surplus, which regulations of the fund indicate the way of disposing of it. This can never happen in commercial insurance where the company owns the premiums contractually and in terms of actual possession. That is to say, in commercial insurance, premiums represent revenue and profit for the insurance company.

9. In cooperative insurance, returns on investment of premiums - after deduction of management costs which go to managing company - belong to the policyholders' fund, while such returns belong to the insurance company in commercial insurance.
10. On liquidation of the cooperative insurance fund, its assets are either spent on charitable purposes or distributed among participants instantly (as indicated in detail in clause 13 hereafter), where such assets go to shareholders in commercial insurance.
11. In cooperative insurance, the company is bound to observe relevant rules of Shariah and fatāwa (Shariah Opinions) of its Shariah Board, a situation which is irrelevant to commercial insurance.
12. Cooperative and commercial insurance are similar in consideration of the basic principles of insurance, including:
  1. Principle of Insurance Interest: This is the legal right of insurance that stems from a legally recognized financial relationship between the insurance client and the subject matter of insurance.
  2. Principle of Good Faith: means the positive and voluntary duty of strict and perfect disclosure of all essential facts relating to the risk insured against, whether such facts are requested or not.
  - Principle of Close Direct Cause: This refers to that adequate cause that is sufficient to set in force a series of incidents constituting the cause of the result that originates from them, without the invention of any other factor stemming from an independent new source and breaking the series.
1. Principle of
2. Principle of
3. Principle of Substitution and

Cooperative insurance also has its own distinguishing principles, which include:

1. Abidance by rules and principles of Shariah in all transactions and



2. No insurance for Shariah
3. Avoidance of any transaction that involves receipt or payment of ribā (usury).

The following is an overview of the most important foundations and principles of Islamic cooperative insurance:

### **Clause (1): Definition**

Cooperative insurance is the participation of a group of people who face certain risk(s) agree that each of them contributes a specific amount, based on cooperation, to a non-profit fund that is to be used for compensating anyone of them for the harms he would encounter when the risk in question materializes, as per signed contracts and adopted regulatory legislations.

### **Clause (2): Forms of Cooperative Insurance Management**

Cooperative insurance is managed by an independent licensed body that works in compliance with the rules of Shariah and may take one of several forms of which most notable are the following:

1. A selected panel of policyholders.
2. A specialized insurance management
3. A Public institution established by and report to a state or number of

### **Clause (3): Relationship between Insurance Fund and Management**

Relationship between insurance fund and the managing party is as follows:

1. Regarding management of insurance business: relationship is according to agency contract, with or without
2. Regarding investment, the relationship is governed by either an agency or a muḍārabah contract. When an agency contract is used, the agency can be against pay or not. When using muḍārabah, the managing party is entitled to a share in the profit as per the

agreement, whereas loss is borne by the capital owner, except in case of negligence or default or breach of conditions or regulations.

## **Clause (4): Pay for Management**

Pay for management takes one of two forms:

1. When cooperative insurance business is managed according to rulings of the agency contract, pay for managing party can be a lump sum or a given percentage of contributions.
1. When management of investment assets of participants' fund is arranged through muḍārabah, the muḍārib (managing party) is entitled to a given percentage of the profit, whereas if the investment is according to agency contract, pay could be a lump sum or a given percentage of invested

## **Clause (5): Ownership of Contributions and Returns on their Investment**

Contributions and net returns on their investment are considered the rights of cooperative insurance fund, whereas the rights of policyholders in the fund are determined according to the insurance system and entitlement conditions regarding compensation and insurance surplus.

## **Clause (6): Remuneration of Insurance Business Managing Party**

Remuneration or pay for insurance business management is estimated subject to fair criteria set by an independent body such as an institution of insurance supervision or through negotiation between representatives of the fund or any party chosen by participants to oversee their interests and the managing party.

## Clause (7): Responsibility of the Fund:

The cooperative insurance fund bears any losses, whether in investment or in insurance activities, except when such losses originate from negligence, default or breach of conditions or regulations by the managing party, who should bear them in such case.

## Clause (8): Insurance Surplus of the Fund

Insurance surplus is the financial balance that remains from collected contributions in addition to its investment returns and any other revenues, after payment of compensations and deduction of necessary allocations and reserve balances, as well as all due expenses and outstanding commitments of the fund.

The entire insurance surplus can be retained in the fund or distributed, totally or partially, among policyholders in a way that achieves justice and conforms to regulations of the fund.

## Clause (9): Cooperative Insurance Fund Deficit and its Cases

In case of failure of cooperative insurance fund to pay its due commitments, the managing company may resort, without commitment, to one or more of the following actions:

1. Borrowing from a third
  2. Provision of *qard ḥasan* (benevolent free loan) from the managing
- 
1. Increasing the amount of contribution after the consent of
  2. Agreement with compensations' beneficiaries to reduce their amounts or pay them in installments.

The managing company may also resort to any other arrangements it deems suitable after clearance by the fund's Shariah Board.

## Clause (10): Reinsurance

1. It is permissible for the cooperative insurance company to conclude re- insurance contracts, taking into consideration that the reinsurance trans- actions it takes part in by virtue of such contracts conform to rulings of Shariah and basic principles of cooperative insurance as decided by its Shariah Supervisory Board.
2. Cooperative insurance companies should be committed to doing all their reinsurance arrangements with Islamic reinsurance companies. When it is impossible, for reasonable justifications, to observe such commitment, they may conclude reinsurance contracts with conventional reinsurance companies to the extent of their real needs and in conformity with the criteria set by Shariah boards and any other criteria they deem suitable, including the following:
  1. Cooperative insurance companies should keep the ratio of conventional reinsurance coverage at the minimum
  2. Managing party should not direct reinsurance premiums paid to the cooperative insurance company to any type of investment that does not comply with rules and principles of Shariah. Further, the managing party should neither claim a share in the returns on investments of conventional reinsurance companies nor should it accept to bear any portion in the losses incurred by investments of these companies.
  3. Cooperative insurance companies should not pay or receive any interest relating to their reinsurance arrangements with conventional reinsurance. Additionally, reinsurance funds should be kept with cooperative insurance companies rather than with conventional reinsurance companies.
  4. Agreement with conventional reinsurance companies should be for the minimum possible period.

## Clause (11): Shariah Compliance

Cooperative insurance management should comply with the rules of Shariah in all insurance operations, activities and investments.





## **Clause (12): Shariah Supervision**

A cooperative insurance company should appoint a Shariah supervisory board and a Shariah audit body as has been stated in the Academy resolution no. 177 (3/19) on *Role of Shariah Supervision in Controlling Islamic Banking Business (Significance, Conditions and Modus Operandi)*. Appointment and operation of this Shariah board should be subject to the approval of the central Shariah supervisory body, if any.

## **Clause (13): Fund Liquidation**

When a cooperative insurance fund is liquidated, its assets can be channelled into charitable purposes or distributed among participants according to fair bases after meeting its technical and legal commitments subject to the regulation of the fund and under supervision of the public authority of Shariah supervision. The fund manager, in this case, is not entitled to any share of the assets.

## **Clause (14): Disputes Resolution**

Disputes that arise between the cooperative insurance company and policyholders should be dealt with according to prevailing regulations and laws, starting from reconciliation, then arbitration, and finally resorting to a competent judiciary body.

## **Clause (15): Relationship between Participants of the Cooperative Insurance Fund**

The relationship between participants of the fund is a form of cooperation in which a group of people agree to contribute specific amounts so that the proceeds of their contributions be used in compensation for harm or realization of interest to any one of them when the need arises. Such cooperation is based on forgiveness, equality and permissibility of benefiting from the rights of each other, rather than on reciprocal compensation, stinginess, and drive for

profit. Therefore, a lot of *gharar* can be excusable under this type of arrangement, which also has nothing to do with *ribā*. Several instances to substantiate this fact can be quoted from Shariah, such as:

First: The divine order to cooperate in the cause of righteousness and piety. In this regard, Allāh the Almighty says, «Help ye one another in righteousness and piety, but help not ye one another in sin and rancor.» (Al-Mā'idah, 2)

Second: The Ḥadīth of the Asharis (Prophetic tradition about the Ashari

people) narrated by Abū Mūsā al-Ashari *يضر هلالا هنع* who told that the Prophet SAW said, “When the Asharis encounter food shortage during invasion, or have insufficient food stocks for their families in Madinah, they used to collect and pile up all the food they have on a piece of cloth and divide it equally among themselves. (Therefore) Asharis are my people, and I am one of them.” [Agreed upon]

Commenting on this ḥadīth, Imam al-Nawawī said,

In this ḥadīth there is the virtue of the Asharis, the virtue of altruism and consolation, and the virtue of sharing food supplies during travel as well as in urban communities when there is food shortage. The ḥadīth does not refer to “Division” as it is known in Fiqh writings with all its conditions, its prohibition in *ribāwiyāt* (*ribā*-liable commodities), equality requirement and the like. What the ḥadīth seems to refer to is permissibility among the Asharis (to get equal shares) and their consolation to each other with what they had. (Al-Nawawī's Commentary on Ṣaḥīḥ Muslim, 16/62)

Third: *Nahd* or *Munahada* (Sharing): Imam al-Bukhārī indicated the concept of *Nihd* in the form of a long title as follows: *Chapter on Sharing, Sharing in Food, Nahd and goods and how a commodity that should be measured in terms of weight or volume is divided by rough estimate or by handful, when Muslims saw no harm that one eats some and another eats some of their footstock, and also using rough estimate in dividing gold and silver, or eating two dates at a time.* What is meant here is the contribution of a group of travellers to all travelling expenses and dividing such expenses among them.

Ibn Ḥajr al-ʿAsqalānī also indicated that *Nihd* or *Nahd* refers to equal sharing of sustenance items while on travel. He further elaborated that usually, sharing comprises a multitude of

items, among which are food items, including *ribā*-liable commodities. Yet, according to al-‘Asqalānī, *ribā* restrictions on exchange of *ribā*-liable commodities is forgiven in the case of *Nihd*, because proof of *Nihd* permissibility is well established. (Fatḥ al-Bārī, 5/128)

### **Clause (16): Fund Autonomy**

Cooperative insurance fund should be independent and may comprise other donations besides those of participants. Independence of the fund can be ensured by granting it a legal personality decided by law or through complete separation of its accounts from those of the managing party. Alternatively, a charitable cash *Waqf* can also be established based on the permissibility of such type of *Waqf*.

### **Clause (17): Withdrawal from Fund**

Cooperative insurance policy regulates cases of withdrawal according to regulations, conditions and criteria cleared by Shariah Board, without inflicting any harm on others.

### **Clause (18): Contribution to Insurance Fund**

1. Contribution is determinable according to actuarial principles based on statistical techniques, with due consideration to whether the risk is constant or variable. The determination process would also involve applying the principle of proportionality between contribution and risk itself and taking into consideration the type and period of contribution, as well as the amount of insurance
2. The risk insured against must be of probable occurrence, rather than just relating to the will of the insurance client, and should not relate to a prohibited

### **Clause (19): Substitution**

Fund management substitutes participant it compensates for injury inflicted upon him in suing harm inflictor in all lawsuits and rights, and the proceeds thus collected goes to the fund.

## **Clause (20): Bearing Part of Liability**

It is permissible to stipulate in the insurance policy that the insurance client has to bear a lump sum or a percentage of compensation amount for harms that others inflict upon him or those he inflicts upon others.

## **Clause (21): Ownership of Premiums**

It is permissible for the fund to own contributions, and in that case, policy- holders will no longer remain owners of their contributions as soon as they pay them. In this case each, the policyholder is considered to have assigned his right of owning his contribution to the fund. One of these two options, of owning or relinquishment, of the right in contribution should be explicitly mentioned in insurance policy.

### Recommendations

1. Communication of these rulings, bases and conditions to concerned parties in Muslim countries, especially those responsible for issuing rules and regulations, cooperative insurance companies and other interested
  2. Operationalization of what has been stated in the Academy resolution 480
1. 177 (3/19) concerning call upon Muslim countries to establish central supervisory bodies to oversee the activities of supervisory boards of Islamic financial institutions and cooperative insurance companies.
  2. Call for establishment of an international Shariah board under the supervision of the Academy with the participation of landmark institutions of the Islamic financial industry including:
    - Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

- Islamic Development Bank Group (ISDB).
- Islamic Financial Services Board (IFSB).
- General Council for Islamic Banks and Financial Institutions (GCIBFI).

Among the essential functions of the proposed board is the issuance of Shariah standards that regulate cooperative insurance and Islamic banking activities, getting such standards ratified by the Academy and facilitating their adoption by supervisory and regulatory bodies as the laws that govern the work of Islamic financial institutions. The ISDB and the Secretariat of the Academy may coordinate for developing the detailed proposal on the working modalities of the board.

4. The Secretariat of the Academy should mobilize more studies on some issues of cooperative insurance, including:
  - Presentation of international experiences in the field of cooperative insurance and exploring their abundance by the bases adopted in this
  - Studying the idea of remunerating the managing party for management of insurance operations through a specific amount or ratio of the insurance surplus without allocating any part of contribution proceeds for payment of management expenses.
  - Studying the idea of remunerating the party that manages insurance operations through a combination of a ratio of contribution proceeds along with a ratio of the insurance surplus to ensure motivation of management for enhanced performance.
  - Studying the different aspects relating to the Waqf-based cooperative

*Indeed, Allāh is the Giver of Success.*