

Legitimacy of Adapting Common Law in Islamic Financial Services Act 2013

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Abstract

Takaful business in Malaysia is governed by Islamic Financial Services Act 2013 which provides for the regulations of Takaful and other Islamic finance related business in Malaysia. However, the Act itself is not comprehensive and is relying on many other established Acts that mostly based on the principles of English Common Law. Hence, this paper will evaluate the Islamic ruling of applying the Common Law in the Act based on the Islamic doctrine al-'Urf. The analysis finds that the application of the Common Law in Islamic Financial Services Act is generally permissible provided that the rules do not contradict with any existing Islamic texts.

Keywords: Common Law, Insurance, Takaful, *al-'Urf*

1. Overview

Malaysia has been acknowledged as the pioneer of Islamic insurance or Takaful in South East Asia by introducing the Takaful Act in 1984 and incorporating the first Takaful operator i.e. Syarikat Takaful Malaysia in 1984. For more than twenty years, the Takaful industry in Malaysia has grown rapidly under the governance of this Takaful Act 1984 by currently having 12 Takaful operators with total fund assets of RM 20.9 billion and net contributions of RM 6.2 billion (Bank Negara Malaysia, 2013). The Takaful performance of Takaful Business Growth is presented in Table 1 below.

Table 1: Key Indicators of Takaful Business Growth in Malaysia 1996 – 2013

Year	No. of Takaful Operators	Asset Funds (RM million)	Contributions (RM million)	Foreign Ownership	Number of Takaful Operator with International Joint Venture
1996	2	295.6	196.4	NIL	NIL
2013	12	16,948.1	4,862.5	3	7

Source: Bank Negara Malaysia, 2013

On 22 Mac 2013, the Central Bank of Malaysia has published a new Islamic Financial Services Act superseding the Takaful Act 1984. Comparatively, this new Act has significantly decreased its dependency on several acts and written law such as Insurance Act 1996 that are now replaced by Financial Services Act 2013. Nevertheless, it still refers to several other acts such as Company Act 1965, Contract Act 1950 and Road Transport Act 1987. These laws have indeed developed based on the English Common Law. The Common Law itself has its strong foot in Malaysia, as it is a part of the constitution of Malaysia laws was written in the Sections 2 and 5 of Malaysia Civil Law Act 1956. Common Law was a product of British colonization in Malaya and Borneo in the early 19th century to 1960s.

It is worth noting that the jurisdiction of Malaysia courts on Takaful cases relies heavily on the civil court rather than to *shariah* courts.

The roles of both courts are laid down in List I and II, Ninth Schedule of the Federal Constitution 1957. The civil court has the jurisdictions on civil and criminal procedure and the administration of justice, contracts, arbitration, mercantile laws that obviously which include insurance and Takaful. The *shariah* court, on the other hand, only handles Islamic personal and family law such as marriage, divorce, guardianship, maintenance, adoption, legitimacy, family law, gifts or succession, testate and intestate (Federal Constitution, 2006).

Since the Common Law is broadly influential in the Islamic Financial Services Act 2013, one may wonder to what extent the law is applied upon the judgment of Takaful cases particularly when it is brought into the civil court. Furthermore, the most important concern to address is the legitimacy of such application from the Islamic perspective. Therefore, this paper attempts to evaluate the act of applying the Common Law in the Islamic Financial Services Act 2013 based on the Islamic doctrine *al-Urf*.

The remainder of the paper is set out as follows. Section 2 provides an overview of the common law and its development. Section 3 discusses the common law application in the Islamic Financial Services Act 2013 followed by Doctrine *al-Urf* in Section 4. Section 5 presents the legitimacy analysis from the *shariah* perspective and Section 6 concludes.

2. Common Law

The Common Law refers to the body of customary or case law developed by judges based on a precedent of the superior courts (Sidhu, 1993; Parsons, 2004; Hill, P., McAuliffe, T. & Peck, A. J., 2005). The precedent is a principle or rule established in a previous legal case that is either binding on or persuasive for a court upon deciding subsequent cases with similar issues or facts (see Sidhu, 1993; Parsons, 2004; Hill et al., 2005)

The doctrine of binding precedent requires a judge to base their decision on the principle of law established in earlier cases where the facts were the same. The judge must choose which parts of the earlier decision are binding on them and this principle is known as *ratio decidendi* (literally means as the reason for deciding). The *ratio decidendi* is based on Parsons, (2004) and Hill et al, (2005):-

- The material facts of the case
- The decision of the judge or judges
- The reason or reasons for the decision

For example, the *ratio decidendi* of the famous negligence case law of *Donoghue v. Stevenson* in 1932 is the principle of duty of care (Parsons, 2004; Hill et al., 2005). It means a person owes a duty of care to those who he can reasonably foresee will be affected by his actions. This case has become the precedent and it is often cited as the source of the tort in many case laws related to product liability as the manufacturer must ensure its products are safe.

In addition to the *ratio decidendi*, the judges may also pass a number of comments in their verdicts. The comments may concern hypothetical situations or may concern questions which may not of importance to the decision. This is known as *obiter dicta*, which is not part of the *ratio decidendi* or binding for the future. However, *obiter dicta* may be persuasive in future cases particularly if the words come from the superior court (see Parsons, 2004; Hill et al., 2005; Garner, 2009)

2.1 Development of the Common Law

The term 'Common Law' originally derives from the reign of King Henry II of England, in the 1150s (Parsons, 2004). It was the law that emerged as 'common' throughout many earlier laws before the Norman Conquest (1066) in England as the king's judges followed each other's decisions to create a unified common law throughout England. He developed the practice of sending judges from his own central court to hear the various disputes throughout the country. The King's judges would resolve disputes on an ad hoc basis according to what they interpreted the customs to be. They would then return to London and often discuss their cases and the decisions they made with the other judges.

The decisions would be recorded and filed. In time, a rule, known as *stare decisis* (also commonly known as precedent, meaning 'let the decision stand') developed, whereby a judge are bound to follow the decision of an earlier judge if the two cases had similar facts to one another. Also, all lower courts should make decisions consistent with previous decisions of higher courts. Though this rule marked the beginning of the precedent system, the early judges would not regard themselves as being compelled to follow previous decisions.

There were still a lot of acts of reversing, overruling, disapproving or distinguishing the earlier case by the judges but all these had cumulatively contributed to a better and stronger precedent case law.

Gradually, the pre-Norman system of local customs and law varying in each locality was replaced by a system that was common throughout the whole country, hence the name 'common law' in 1150s. The Law has constituted the basis of the legal systems of England and Wales, federal law in the United States and the law of individual U.S. states (except Louisiana), and many other Commonwealth countries including Malaysia (Wikipedia).

As for the general objective of the Common Law and its flexibility, Justice McCardie in *Prager v Blatspiel and others* (King's Bench Division, n.d.; Westlaw, n.d.) said:

"The object of the common law is to solve difficulties and adjust relations in social and commercial life. It must meet, in so far as it can, sets of fact abnormal as well as usual. It must grow with the development of the nation. It must face and deal with changing or novel circumstances. Unless it can do that, it fails in its function and declines in its dignity. An expanding society demands an expanding common law."

3. Adoption of Common Law in Islamic Financial Services Act 2013

In Malaysia, Takaful (Islamic insurance) business is governed by the Islamic Financial Services Act 2013 (superseding the previous Takaful Act 1984). The Act provides for the regulation of Takaful business in Malaysia and for other purposes related to Takaful. Whilst the Governor of the Act is the Central Bank of Malaysia. The Act also makes a provision by virtue of Section of 28 (2) that all Malaysia Takaful operators must be supervised by the *Shariah* Advisory Council (SAC), also known as *Shariah* Supervisory Council. The *Shariah* Advisory Council will provide advices to the operators on their Takaful business to ensure that they do not involve in any element which is not approved by *shariah* (Bank Negara Malaysia, 2013).

The Islamic Financial Services Act 2013 has reinforced the role and functions of SAC as provided in earlier Central Bank of Malaysia Act 2009. The SAC was conferred the status of the sole authoritative body on *shariah* matters pertaining to Takaful, Islamic banking and Islamic finance. While the rulings of the SAC shall prevail over any conflicting ruling given by a *shariah* body or committee constituted in Malaysia, the court and arbitrator are also required to refer to the SAC rulings for any proceedings relating to Islamic financial business, and such rulings shall be binding (precedent).

Despite of the provisions discussed above, the Islamic Financial Services Act 2013 itself is not a standalone and comprehensive. There are many sections such as Part 1 Section 1 (2), Part 5 Section 50 (2), 60 (2), 217 (4), 218 (5) and 279 (1) expressly stating that the provisions herein shall prevail if there is any conflict or inconsistency with other acts namely the Insurance Act 1963 (superseded by Insurance Act 1996), Companies Act 1965, the Contract Act 1950, the Road Traffic Ordinance 1958 (superseded by Road Transport Act 1987) and the Co-Operative Societies Act 1948. This impliedly means that if there is no provision made in the Islamic Finance Services Act 2013, hence other law will apply.

Generally, the written laws including insurance law (other than Takaful act) which is applicable in Malaysia are based on the principle of the Common Law. The said application is by virtue of Sections 3 and 5, Civil Law Act 1956. Section 3 of the Civil Law Act stated that the English Common Law shall be applied only in Malaysian civil cases where no specific laws have been made. Section 5 administered on the application of English Law in commercial matters with respect to the law of partnership, corporations, banks and banking, principals and agents, carriers by air, land and sea, marine insurance, average, life and fire insurance, and with respect to mercantile law generally.

Insurance law, as part of the mercantile law, developed under the English Common Law (Sidhu, 1993). For example, under the Common Law, if a driver was killed in an accident due to his own negligence, any claim for compensation either from the deceased or any third party involved in the accident will not be entertained. The English Road Traffic Act 1930 was the first that made motor insurance against third party risk compulsory in the United Kingdom. In Malaysia, the same law has been adapted on which the compulsory motor insurance against third party was introduced by the Motor Vehicles (Third Party Risks) Regulation 1946 and superseded by the Road Traffic Ordinance 1958 and is now contained in the Road Transport Act 1987. It is not only to provide the protections to third parties for any risk of damage and accidents caused by vehicle used, but also to regulate the motor vehicles and traffic on the road.

There are several examples on which the Islamic Financial Services Act 2013 are silent and hence need to apply other written laws (that are based on the Common Law):-

a. Insurable Interest

Similar to conventional insurance, the issues of ‘insurable interest’ and *uberrimae fidei* (utmost good faith) are equally valid in Takaful contract. The nature of family Takaful is such that the issue of insurable interest is automatically taken care of since the participant himself is both the covered person and the certificate holder. However, in case of general Takaful (such as fire, accident and motor certificates), even though the Islamic Financial Services Act 2013 is silent on insurable interest, yet the general provisions of the Contract Act 1950 against wagering contracts is applicable to these contracts requiring the participant to show sufficient interest in the subject matter, both at the inception and the time of loss. The principle of *uberrimae fidei* is emphasized equally under the Islamic law of contract and its rules regarding honesty, full disclosure, truthfulness and utmost good faith. Non-compliance of these makes the contract, including Takaful contract, void.

b. Valued Policy

A valued policy is the policy which specifies the agreed value of the subject matter insured. In the case law of *Teng Gia Hwa & 1 or v Syarikat Takaful Malaysia Bhd* (2010), the judge issued the verdict based on the English law of Marine Insurance Act 1906 since there is no provision in the Islamic Financial Services Act 2013. Syarikat Takaful Malaysia at the point of Takaful application had accepted the valued policy of the participant’s vessel at RM500,000, however disputed to pay the sum after the vessel was missing. The judge opined that it is allowed by the Common Law to presume the actual loss of the vessel.

The above lists are not exhaustive and it might require an in-depth study to ascertain the whole gap of the Islamic Financial Services Act 2013 in relation to Common Law. The main point to be highlighted here is that the Common Law is still applicable in Takaful cases despite of the existence of Act and the *Shariah* Advisory Council. Hence, the question is whether such application is permissible by Islam? Can the long established customary law i.e. Common Law being regarded as a valid ‘*Urf*’ as permitted in Islam as a source of rulings? To answer this question, we need to understand the doctrine of ‘*Urf*’ (custom) and its lawfulness from the Islamic perspective.

4. Doctrine of Al-Urf

The term ‘*Urf*’ etymologically originated from Arabic word ‘*arafa*’ meaning to know. It is literally defined as *ma’rifah*, with the meaning as something that is right, the usual practice, which is considered to be good and accepted by a healthy mind (Saleh, 2000; al-Jurjani, 1405). Technically, the term refers to the custom in the public or the majority of a people in the word (‘*Urf qawli*’) or practice (‘*Urf amali*’). The definition is given by al-Zarqa’ (1961), al-Zuhaili (1996) and al-Ghazali (1356).

Examples of ‘*Urf qawli*’ can be extracted from verse *al-Nahl* as follows:-

“It is He who has made the sea subject, that ye may eat thereof flesh that is fresh and tender, and that ye may extract therefrom ornaments to wear; and thou seest the ships therein that plough the waves, that ye may seek (thus) of the bounty of Allah and that ye may be grateful.”

Translation of verse *al-Nahl* (16): 14

Based on custom and ‘*Urf*’, the word ‘tender meat’ herein refers to fish instead of all type of meat.

Examples of ‘*Urf amali*’ is a silence or act of nodding which is commonly understood as a successful offer and acceptance between the parties to the contract.

The ‘*Urf*’, be it *qawli* or *amali*, has two categories (al-Zuhayli, 1996; Nur, 1993):-

1. From the perspective of coverage.

There are two types of ‘*Urf*’:-

- a. ‘*Urf amm*’ (general customs), which is an act or word that is the norm around the world and all countries and is sustained over time. For example, entering into a mosque without removing shoes or slippers is deemed to have insulted the honor and the sanctity of mosque. This has been commonly accepted by Muslim worldwide.

b. *'Urf khas* (specific customs), which customs that become a trend or is known only among the people and communities in a country or region or in the area and certain groups. For example, a person who wishes to enter a Muslim house in Malaysia without removing shoes or slippers is considered rude and insulting the host. However, the situation is different for Western countries like the United States.

2. From the perspective of legality:

- a. *'Urf shahih* (approved customs), which refers to the customs associated with the act, word, whether specific (*khas*) or general (*'amm*) that it is not contrary to Islamic texts.
- b. *'Urf fasid* (rejected customs) is contrary to *'Urf shahih* which is contradicting with Islamic texts. For example, the application of bank interest falls under this category as it is against Islamic ruling.

In principle, the application of *'Urf* is permissible and its ruling is certified by the scholars based on the following evidence: -

“Hold to forgiveness; command what is right; But turn away from the ignorant.”

Translation of verse *al-A'raf* (7): 199

al-Zuhayli (1996), Zaydan (1989) and al-Kasani (1982) have quoted the following hadith in respect of the permissibility of the *'Urf*. al-Sayuti (1996) in his text *al-Asybah wa al-Naza'ir* has deliberated in details on status of the following hadith.

“Whatever is available and is seen by Muslims as a good thing then it is also good in the sight of God”

Although, the scholars have provided a variety of comments on the *'Urf* based on the two texts mentioned above, some of which are al-Sarkhasi, al-Syatibi, al-Sayuti (al-Zuhayli, 1996; Saleh, 1997), and al-Zarqa' (1961). However, they have commonly agreed that the permissible *'Urf* is *'Urf shahih* (be it *'amm* or *khas*) provided it is not in conflict with any Islamic texts and the principle rules of *fiqh* (al-Zuhayli, 1996).

With reference to the concept of *'Urf* and Islamic texts mentioned above, it is hypothetically true to assume that the application of the Common Law in Malaysia Takaful Act 1984 is in compliance with the Islamic doctrine of *al-'Urf*.

5. Legitimacy from Shariah Perspective

Analytically, to ensure that the adoption of the Common Law by Malaysia in the Islamic Financial Services Act 2013 is *shariah* compliance, particularly with doctrine *al-'Urf*, it has to adhere to the following conditions (‘Adil, 1997; Abu Sunah, 2004; Saleh, 2000):-

1. *'Urf* must not be inconsistent with the existing Islamic texts. This is the weightiest condition to the effect that any custom shall be left out of shelves if it is against with Islamic texts.

In connection with the Common Law and its application in the Islamic Financial Services Act 2013, there are so many case laws to be evaluated of the adherence with the Islamic texts. The earlier two subject matters i.e. insurable interest, assignment and valued policy could be a ‘tip of iceberg’ where the actual number may enumerate largely unexpected. The framework of having *Shariah* Advisory Council though is so far the best solution, but there is unfortunately no strict enforcement, direct supervision or involvement of neither *shariah* judges nor scholars in the trial itself hence the civil court may not comply with *shariah* rules.

The closest example is the case law of *Teng Gia Hwa & I or v Syarikat Takaful Malaysia Bhd* (2010) which came after effect of the Central Bank of Malaysia Act 2009 (in respect of *Shariah* Advisory Council authority). The verdict by Judge Datuk David Wong did not make any reference to *shariah* resolution in respect of valued policy and also had included the 4% interest of the judgment sum which is usury (*riba*) and prohibited in Islam.

In the event of no clear quotes in the existing Islamic texts, the principle of *maslahah* (public interest) is applicable. For example, making motor insurance or Takaful a compulsory is based on the Common Law and it is for public interest whereby the vehicle owner is able to pay compensation for bodily injury or death to third parties caused by road accidents. This is consistent with the teaching of Islam for the followers to help each other in any matters that will benefit the public, as the word of God, which means:-

“O ye who believe! Violate not the sanctity of the symbols of Allah, nor of the sacred month, nor of the animals brought for sacrifice, nor the garlands that mark out such animals, nor the people resorting to the sacred house, seeking of the bounty and good pleasure of their Lord.

But when ye are clear of the sacred precincts and of pilgrim garb, ye may hunt and let not the hatred of some people in (once) shutting you out of the Sacred Mosque lead you to transgression (and hostility on your part). Help ye one another in righteousness and piety, but help ye not one another in sin and rancour: fear Allah: for Allah is strict in punishment.”

Translated of verse *al-Maidah* (5): 2

And since the Takaful contract is based on mutual cooperation whereby each participant agrees to help others for their loss, the main objective i.e. compensation is also applied by the Common Law. The concept of compensation that exists in the Common Law has been practiced earlier at the time of the Prophet through the doctrine of *al-Aqilah* or ‘blood money’ (Syabir, 2001) based on the hadith of the following: -

“Two women from ethnic *Huzayl* came into conflict, and at least one was throwing stones and causing the death of another with its contents. They then have been referred to the Prophet, and he has ruled that blood-money or compensation shall be paid on the unborn baby.....” (Muslim, 1988)

2. *Urf* must be adopted by society as a whole and broadly, or even most of them (Saleh, 2000). This condition can be observed in the acceptance of this common law as it is practiced by society in England and later in Malaysia after being adapted into the Islamic Financial Services Act 2013 and other of acts relating to insurance and Takaful in Malaysia.
3. *Urf* or custom must already exist upon being referred to any new emerging case (Saleh, 2000). In this case, the Common Law which is now more than 800 years of practice before has being adapted into Malaysia Takaful and insurance law which are the Islamic Financial Services Act 2013, Civil Law Act 1956 and few other Acts.
4. There is no single word or act openly against the custom practiced (Saleh, 2000). For example, if the parties to the contract agreed to waive the *Urf* or customs, then they should no longer consider that practice as a custom or *Urf*.

6. Conclusion

Based on the analysis above, there are few conclusions that could be made. In principle, the application of the Common Law in the Islamic Financial Services Act 2013 or other law is permitted from Islamic perspective based on the doctrine *al-Urf*. This is on the basis that the Common Law has been established for more than 800 years based on the public interest which is in line with Islamic teachings and been received by many countries worldwide.

“And cooperate in righteousness and piety, but do not cooperate in sin and aggression.”

Translated of verse *al-Maidah* (5): 2

The concept of compensation which is the common and main objective of both Takaful and Common Law so far does adhere to all the four *Urf* conditions. In fact, there is an evidence of the similar practice i.e. *al-Aqilah* has been endorsed by Islam which is much earlier than the Common Law.

For other application of the Common Law in the Islamic Financial Services Act 2013, it has to pass the full test of four conditions particularly the first i.e. not contradicting with any Islamic text. Otherwise, the application of the law shall be deemed as invalid.

“Hold to forgiveness; command what is right; But turn away from the ignorant.”

Translation of verse *al-A'raf* (7): 199

For example, the concept of insurable interest. It was allowed in Takaful contract and is treated as a mandatory to prevent the wagering (*maisir*) which is prohibited in Islam. As such, it is a requirement of the contract to be fulfilled.

“O ye who believe! fulfil (all) obligations (contracts). Lawful unto you (for food) are all four-footed animals, with the exceptions named: But animals of the chase are forbidden while ye are in the sacred precincts or in pilgrim garb: for Allah doth command according to His will and plan.”

Translated of verse *al-Maidah* (5):1

Arising from this analysis, there are at least two recommendations that need to be observed. From the Malaysia context, the authority and jurisdiction of *Shariah* Advisory Council onto the courts and arbitrators need to be reinforced to ensure that the references to any law other than the Islamic Financial Services Act 2013, application of principles from those laws and decision made afterward are in line with the *shariah* rulings.

The second recommendation is that Central Bank of Malaysia should look into dividing the *Shariah* Advisory Council further into several groups of expertise i.e. Islamic banking, Takaful and others. This decentralization would allow more focus given into each sector, hence the harmonization of the laws with Islamic rulings can be effectively implemented in shorter time.

During the period of writing this article, there were several limitations can be observed. Firstly, although there are evidences of the application of the Common Law in the Islamic Financial Services Act 2013 by virtue of the provisions in Civil Law Act 1956 and the Islamic Financial Services Act 2013 itself, it is challenging to ascertain the actual number of real cases whereby such Common Law has been applied. Secondly, in sequence to the above limitation (a), the *Shariah* Advisory Council (SAC) must ensure that their *Shariah* Resolutions in respect of Takaful business have at least covered all the previous cases. As at to date, only 2 editions of *Shariah* Resolutions were issued by the SAC of which the approaches are mostly based on referral basis by Takaful operators (Bank Negara Malaysia, 2013). We would therefore recommend at least three future researches to be conducted in the similar area. A comprehensive study need to be conducted of the Takaful cases brought onto civil court in Malaysia and subsequently analyze the influence of the Common Law in Takaful in the court verdict and its compliance with Islamic rulings.

Secondly, the compliance rate by the civil court in Malaysia with the SAC resolution in regards to Takaful court cases should be examined. The comparison, if possible, can also be done against pre and post enactment of Central Bank Act 2009 that put the resolution as binding, thus able to determine the efficiency of the SAC roles and its authority.

Finally, comprehensiveness of the SAC's *Shariah* Resolutions in respects of Takaful business against the established gap from the above proposed research needs to be measured.

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