

**THE ACCOMMODATION OF THE ISLAMIC LAW INSTITUTION OF  
*TAKAFUL* UNDER THE SOUTH AFRICAN INSURANCE LAW**

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## DECLARATION

I hereby declare that the “**THE ACCOMMODATION OF THE ISLAMIC LAW INSTITUTION OF *TAKAFUL* UNDER THE SOUTH AFRICAN LAW OF INSURANCE**” is my own work and that all sources that I used or quoted have been indicated and acknowledged by means of complete references.

SIGNATURE: BIBI FATIMA SURTEE

DATE: November 2017

**APPROVAL FOR SUBMISSION**

This dissertation has been submitted for examination with my approval as supervisor.

Signed.....Date.....

Professor Mtendeweka Mhango

## ACKNOWLEDGEMENTS

God (*Allah*) has bestowed upon us the nature to be grateful and we should thus express that gratitude, not just to *Allah*, but to the people whom we deal with as well. *Allah* says in the Quran: “***And whatever of blessings and good things you have, it is from Allah***” [al-Nahl 16:53]. I praise *Allah* and thanks are to *Allah* for all his blessing and his guidance to help me achieve my goals and for the completion of this dissertation.

Just as treasure is uncovered from the earth, so too does virtue appear from good deeds and wisdom appears from a pure and peaceful mind. To walk safely through the maze of human life, one needs the light of wisdom and the guidance of virtue. My light of wisdom and guidance is my father and late mother. I give sincere thanks and appreciation to my beloved father, Mr Mohamed Faruk Abdoola Surtee and my late mother Zubeida Surtee for their encouragement, love and support.

I would also like to take a moment to thank Attorney Yusuf Latiff for his assistance and guidance. Mr Latiff has instilled discipline, resourcefulness, motivation and has provided me with invaluable insight. Without his guidance, expertise, knowledge, patience and support, I surely would have faltered. My appreciation also goes to my special friends and family who have showered me with love and support.

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## **ABSTRACT**

With the rapid development of the Islamic banking and finance in South Africa, the legal regime of South Africa, must be able to progress at the same rate of development. The recognition of a foreign legal system such as Islamic law in South Africa is challenging and difficult. South Africa, has an interest based insurance legislative framework and this is not aligned with the principles of the Islamic financial system.

As a result of this, regulators have taken various measures to develop and promote the Islamic Industry. The amendment to the South African Tax legislation has created an equitable and level playing field for Islamic law. The South African government also has a further obligation which is to develop a legislative framework to govern Islamic law, as well as to enhance the regulatory and supervisory framework.

The study of the development of the Islamic legal regime is an important area that aids legal practitioners in identifying and resolving legal disputes. The purpose of this paper is to examine the accommodation of the Islamic law of *Takaful* under the South African Insurance legal framework.

## **KEY TERMS**

Compliance, conflict of law, Islamic Bank, Islamic Insurance, Islamic contracts, Islamic products, insurable interest, *Riba*, *Shariah* law, *Takaful*.

## LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
CPIFR	Core principles for Islamic Finance Regulations
FAIS	Financial Advisory and Intermediary Services Act, 2002
FICA	Financial Intelligence Centres Act,2001
FSB	Financial Services Board
FSP	Financial Services Provider
IFSB	Islamic Financial Services Board
IFSI	Islamic Financial Services Industry
IIFS	International Islamic Financial Services Industry
POCA	Prevention of Organised Crime Act,2004
POCDATARA	Protection of Constitutional Democracy against Terrorism and Related Activities Act,2004

## DEFINITION OF TERMS

The following definitions appear in various places in the dissertation where the sources are cited.

*Allah*: used as the name for God in the Islamic religion.

*Aqd*: refers to the Arabic word for a contract which literally means an obligation.

*Apostas*: refers to bets.

*Ar Rahnu*: refers to an arrangement where a valuable asset is placed as collateral for debt. The collateral may be disposed of in the event of default.

*Bi'l Kalam*: refers to an offer made verbally.

*Bi'l kitabah*: refers to an offer made in writing.

*Emptio ET venditio periculi*: which translates as a purchase and sale of risk.

*Gharar*: is an element of deception either because of ignorance on the status of the goods, the price, or the condition of the goods not consistent with the initial description of the goods. In this case one or both parties stand to be deceived through ignorance of an essential element of exchange. As an example, lottery or gambling is considered as a form of *Gharar* because the lottery buyer or the gambler is ignorant of the result.

*Fatwa*: refers to a legal opinion or decree handed down by an Islamic religious leader.

*Fiqh-al-mu'amalat*: literally means an economic transaction. Technically it refers to lease of land or fruit trees for money or for a share of the crop. It is commercial jurisprudence and the rules for transacting in a *Shariah* compliant manner. This is an important source for establishing the rules for Islamic banking.

*Ghish*: this refers to cheating.

*Ghubon*: this refers to injustice.

*Hadith*: is the narrative relating the deeds and utterances of Prophet

*Halaal*: this concept originates from an Arabic phrase that means allowed or permitted by Islamic Law.

*Haraam*: this refers to conduct that is prohibited in Islamic law such conduct entails trading in alcohol, drug dealing, prostitution and any kind of trade involving uncertainty.

Islamic bank: A company which carries on Islamic banking business and whose aims and operations do not involve any element which is not approved by the religion of Islam.

Islamic finance: is defined as a financial service principally implemented to comply with the main tenets of *Shari'ah* (or Islamic law).

*Ijara*: means to give something on rent and in many respects resembles leasing. The purchaser leases the house from the bank and pays rent. The rental forms part of payment towards the shares in the property.

*Istisna*: This refers to a pre-production financing tool for financing in areas like oil processing, mining construction and manufacturing.

*Khulq*: is the term which describes the habitual and firm disposition in a human by virtue from which moral actions flow spontaneously and effortlessly.

*Lex mercatoria*: refers to that system of laws which is adopted by all commercial nations, and which, therefore, constitutes a part of the law of the land.

*Madrasahs*: refers to a Muslim school, college, or university that is often part of a mosque.



*Majlis al-'aqd*: refers to the sitting for the contract.

*Maysir*: refers to the easy acquisition of wealth by chance, irrespective of whether or not it deprives the other person's rights.

*Qard Hasan*: refers to an interest free loan which is used to finance welfare projects.

*Quran*: is the book of revelation given to the Prophet.

*Riba*: the translation of the Arabic verb *riba* is derived from *Raba* which means increase. *Riba* refers to usury and interest and is the act lending money at a very high rate of interest.

*Riba al-Fadl*: refers to the excess which is taken in exchange of specific homogenous commodities, such as selling gold with another gold, whereby one has more "weight" than the other.

*Riba al Nasiyah*: refers to any excess compensation paid over and above the principal amount which is paid without due consideration.

*Salam*: refers to a sales contract whereby goods are sold before they come into existence.

*Shariah* law: refers to Islamic Law and is an all-embracing body of religious, social and military duties.

*Sukuk*: Islamic bonds, structured in such a way as to generate returns to investors without infringing Islamic law (that prohibits *Riba* or interest).

*Suwkrah*: refers to the Arabic term for an insurance premium.

*Sunnah*: The jurists use the word *Sunnah* in two different ways. On the one hand, they define *Sunnah* as the statements, actions, and approvals of the Prophet Muhammad. On the other hand, the term *Sunnah* is used to indicate actions as being recommended or praise-worthy.

*Takaful*: is a word which describes *Shari'ah* compliant insurance and it stems from the Arabic verb *Kafala*, which means guarantee.

*Tractatus de assecurationibus et sponsionibus mercatorum*: is translated to mean “insurance and merchant’s bets.”

*Ulama*: refers to a body of Muslim scholars or religious leaders.

*Wakala*: This refers to a concept of agency whereby participants join the scheme and contribute premiums to a general fund. This is administered by an agent who receives a fee and such fee is paid out of the investment or profits.

*Zulm*: This means oppression.

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## CHAPTER ONE: GENERAL INTRODUCTION

### 1.1 BACKGROUND OF STUDY

This dissertation is committed to investigate the sources of law that governs Islamic banking and finance. Islamic banking is 'interest free' banking, which means it avoids interest-based transactions as prohibited in the Islamic *Shariah*. As such, financing properties or assets are conducted through the finance options which include *Takaful*.<sup>1</sup>The focal point of this paper will be on *Takaful* Insurance. Therefore the fundamental principles that govern Islamic banking and finance are highlighted.

The dissertation aims to equip the reader with knowledge on a wide spectrum of finance, banking and relevant legal issues in order to create an improved understanding of the practicality of accommodating the Islamic financial product known as *Takaful* in a secular state. Reference will be made to South African law as a comparison to Islamic law, in order to determine how *Takaful* can be accommodated in South Africa. An analysis is made on principles, definitions and key aspects of South African law which can have implications on *Takaful*. A brief overview of the financial sector in South Africa and the regulatory framework governing the sector will be discussed. A case study of Malaysia will be done to show how Malaysia has accommodated their laws to incorporate *Shariah* to govern Islamic banking and finance. Malaysia is chosen because of its avant-garde position in Islamic banking and finance and because of its comprehensive legal and regulatory dual system, which is where conventional banking and finance functions parallel to Islamic banking and finance.

In order to understand modern Islamic law, a brief primer on Islamic contracts is necessary in this dissertation. Islamic finance covers a full spectrum of modern financial areas from loans to insurance. However to understand

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<sup>1</sup> Islamic Finance Options <https://www.banking.org.za/consumer-information/islamic-banking/islamic-finance-options> (accessed 17 January 2019)



Islamic finance, it is important to start with an overview of Islamic law because Islamic finance is the application of Islamic law. This dissertation also examines Islamic Risk Management and Governance and the unique role of the *Shariah* Board in the responsible supervision of Islamic banks.

The study is limited in scope in that the different interpretations, conflict, controversy, the various sects and institutions such as madrassas will not be examined. Nevertheless, these aspects may be alluded to in order to highlight some of the difficulties that exist in South Africa. In this dissertation the terms *Shariah* law and Islamic law are used interchangeably. The objectives of the study have been set forth including the importance, rationale and methodology for the dissertation.

1. To identify law.
2. To analyse the recognition, accommodation and incorporation of *Takaful* in South Africa.
3. To establish the emerging challenges and make necessary recommendations.

#### 1.1.1 Brief Overview of the Financial Sector in South Africa

The financial sector of South Africa influences the lives of all South Africans irrespective of race, colour or creed. This sector enables economic growth, job creation and sustainable development.<sup>2</sup> The financial sector also facilitates daily economic transactions, saves and preserves wealth, which is required for retirement needs and insures against personal disaster for citizens. The financial sector refers to ‘the set of institutions, instruments and the regulatory framework that permit transactions to be made by incurring and

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<sup>2</sup> See forward of Pravin J Gordhan in South Africa’s National Treasury Policy Document entitled “A safer financial sector to serve South Africa better” at 1-2 <http://www.treasury.gov.za/twinpeaks/20131211%20%20Item%202%20A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf> (accessed 23 February 2011)

settling debts; that is, by extending credit.<sup>3</sup> The regulatory framework aims at the protection of the financial sector, including financial institutions and other stakeholders within the economy.<sup>4</sup> For example, regulations ensure that the providers of financial services are licenced and this protects the consumers by promoting market conduct and by prosecuting cases of market misconduct. The maintenance of the safety and soundness of financial institutions and the enforcing of applicable laws are further aims of regulators.

The regulatory regime chosen for insurance depends on the type of services provided. Service providers are not allowed to operate outside the regulatory framework.<sup>5</sup> Insurance is a hazardous business and if insurers do not adhere to sound business practices, disaster may strike such insurance companies. Measures to control insurance were introduced way back in the *lex mercatoria*<sup>6</sup> of the Middle Ages and continue today. Currently, in South Africa there are various enactments adopted to control the insurance and financial industry. The South African government decided to introduce legislation in the insurance and banking sector because these businesses attract huge sums of capital and long-term investments. Over the past few years, South Africa's regulatory framework which relates to market conduct and consumer protection in the financial services has been bolstered, by the

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<sup>3</sup>OECD "Glossary of statistical terms: financial sector"  
<http://stats.oecd.org/glossary/detail.asp?ID=6815> (accessed 4 May 2015)

<sup>4</sup> See, Remarks by Alastair Clark, Adviser to the Governor, Bank of England entitled "Prudential regulation, risk management and systematic stability" at the China International Banking Convention,  
<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2006/speech286.pdf>  
<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2006/speech286.pdf> (accessed 4 May 2015)

<sup>5</sup> Financial Sector Regulation and Reform  
<http://www.treasury.gov.za/documents/national%20budget/2016/review/Annexure%20d.pdf>  
(accessed 12 July 2017)

<sup>6</sup>That system of laws which is adopted by all commercial nations, and which, therefore, constitutes a part of the law of the land. <https://dictionary.thelaw.com/lex-mercatoria/>  
(accessed 12 July 2017)

introduction of a number of laws to protect consumers.<sup>7</sup>The laws include but are not limited to the Insurance Law Amendment Act <sup>8</sup>(Hereinafter referred to as the ILA), the Financial Services Board Act<sup>9</sup> and the Financial Intelligence Act.<sup>10</sup>

As with all other industries, the insurance industry has to be innovative in order to survive and grow. As a result, the industry is constantly in search of new markets to serve consumers and new products to market. A substantial growth has taken place in Africa, in the marketing of Islamic financial products which includes Islamic insurance. Many companies marketing financial products cater for Islamic insurance and banking products and have in the process found this to be a lucrative market.<sup>11</sup> South Africa has seen a dominant growth of Islamic banking with the Albaraka Bank <sup>12</sup> as the key player in Islamic banking. Whilst other companies such as Absa Bank<sup>13</sup>and Old Mutual<sup>14</sup> have followed pursuit. The South African Islamic Banking and

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<sup>7</sup> Dube T 'New financial regulator will better protect consumers <https://www.iol.co.za/personal-finance/new-financial-regulator-will-better-protect-consumers-12319245> (accessed 12 December 2015)

<sup>8</sup> Insurance law Amendment Act 27 of 2008

<sup>9</sup> Financial Services Board Act 97 of 1990

<sup>10</sup> Financial Intelligence Act 38 Of 2001

<sup>11</sup> Habib MN "Explaining the *Takaful* Experience"<https://www.cover.co.za/explaining-takaful-experience/> (accessed 17 August 2017).

<sup>12</sup> Al Baraka bank limited, "registered in South Africa since 1989 and pioneered Islamic banking in this country in response to an identified need for a system of banking which adhered to Islamic principles [http://www.albaraka.co.za/aboutAlbaraka/corporate\\_profile.aspx](http://www.albaraka.co.za/aboutAlbaraka/corporate_profile.aspx)(accessed 7 November 2014)

<sup>13</sup> Absa bank limited (Absa bank), with preference shares listed on the JSE Limited, is a wholly-owned subsidiary of the Barclays Africa Group. The Absa Islamic Banking division was established in March 2006 and provides for a variety of specialised banking, saving and investment solutions that operates in strict compliance with *Sharia* law. <http://www.absa.co.za/Absacoza/Individual/Banking/Exclusive-Banking/Islamic-Banking> (accessed 7 November 2014)

<sup>14</sup> Old Mutual offers investors access to unit trust funds that are aligned with the purity of Islam's spiritual and ethical beliefs. <http://www.oldmutual.co.za/personal/investments->

Insurance industry is legislated under conventional laws which include and it is not limited to the Banks Act,<sup>15</sup> Mutual Banks Act,<sup>16</sup> Co-operative Banks Act,<sup>17</sup> Short-Term Insurance Act<sup>18</sup> and the Long-Term Insurance Act.<sup>19</sup> These Acts are the main instruments which govern both conventional and Islamic financial institutions whilst these pieces of legislation do not forbid the offer of Islamic financial products by South African financial institutions, they do not take into account the Islamic financial industry. It is only the Taxation Laws Amendment Act 7 of 2010, which gives definition for diminishing *Musharaka*, *Mudaraba*, and *Murabaha*, concepts which are discussed later.

It is evident Islamic banking and insurance are recognised in South Africa and may be considered as an alternative to the conventional philosophies of banking.<sup>20</sup> However, Islamic banking and insurance continues to be governed by legislation underpinned by capitalist ideologies, which are not always compatible with the requirements of Islamic law. Islamic commercial law contains restrictions which are generally unfamiliar to lawyers in the Western communities. The restrictions on Islamic law are discussed in general.

#### 1.1.2 The Restrictions on Islamic law

*Takaful* is a form of Insurance permitted under Islamic law and is the main focus of this study. The concept of *Takaful* and the restrictions on Islamic law

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[and-savings/investing-for-growth/unit-trusts/products/shari'ah-range.aspx](http://www.fsb.co.za/and-savings/investing-for-growth/unit-trusts/products/shari'ah-range.aspx) (accessed 7 November 2014)

<sup>15</sup> The Banks Act 94 of 1990

<sup>16</sup> Mutual Banks Act 124 of 1993

<sup>17</sup> Co-operative Banks Act 40 of 2007

<sup>18</sup> Short-Term Insurance Act 53 of 1998

<sup>19</sup> Long-Term Insurance Act 52 of 1998

<sup>20</sup> Amman M "Islamic Compliant Insurance from FNB" <https://www.iol.co.za/personal-finance/islamic-compliant-insurance-from-fnb-8855321> (accessed 29 September 2017)

have been addressed in order to try and relate the study to the various concepts and theories related to its main focus which is, 'The Accommodation of the Islamic Law Institution of *Takaful* under the South African Insurance Act.' Islamic law has a number of restrictions, which are foreign or unfamiliar to the capitalist system applicable in South Africa. Islamic law prohibits interest (*Riba*), speculation (*Maysir*), uncertainty (*Gharar*), oppression (*Zulm*), cheating (*Ghish*), injustice (*Ghubon*) and trading in prohibited commodities, for example, gambling, prostitution, etc.<sup>21</sup> Islamic products are regulated by a system of rules arising from Islamic law which are taken into account both in the customised products that are offered and the market segment that is catered for.<sup>22</sup>

Islamic instruments in banking and insurance, including *Takaful*, have gained popularity in different parts of the world particularly on account of recent global financial crisis.<sup>23</sup> In South Africa, Islamic financial instruments have become popular.<sup>24</sup> This is due to the fact that there is a small but affluent Muslim community, which is considered a significant market segment by the financial institutions. Third world countries including those in Africa have become convinced that by removing the interest factor of financial transactions some of the burdens placed on poorer communities can be lifted. The growth of Islamic instruments can take place more equitably without

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<sup>21</sup> Qasaymeh (2011) *Comparative and International Law Journal of Southern Africa* at 276

<sup>22</sup> Dr H Amin "Religiosity Index for Islamic Home Financing in Sabah" <https://islamicbankers.files.wordpress.com/2017/06/religiosity-index-for-islamic-home-financing-in-sabah-new-article-27th-may-2017.pdf> (accessed 3 July 2017)

<sup>23</sup>T Hirst "These are the top 9 countries for Islamic finance" <https://www.weforum.org/agenda/2015/07/top-9-countries-islamic-finance/>(29 July 2017)

<sup>24</sup> Hesse M "Islamic finance is based on Shared-Prosperty" <https://www.iol.co.za/personal-finance/islamic-finance-is-based-on-shared-prosperty-9230978>(accessed 29 July 2017)

benefiting the rich and marginalising the poor as has become common to both the first world and especially the third world countries.<sup>25</sup>

The anomalies and potential hazards that can arise from the introduction to Islamic products create a need for scrutiny. This can be monitored by the industry and government to find ways to avoid conflict and possible abuse. They can also find ways of accommodating such products through institutionalisation and regulation.<sup>26</sup>

## 1.2 Statement of the Problem

Islamic financial instruments have their own peculiar features.<sup>27</sup> Contemporary writings confirm that Islamic law prohibits interest whilst the widespread adoption of Western banking practices is driven by interest. Therefore the accommodation of Islamic law into South Africa has its challenges. The area of concern that arises from the growing practice of Islamic finances and insurance in a country such as South Africa is that, South Africa has an economic and legal system which is very different from the system in which Islamic finance and insurance were created to operate.<sup>28</sup> Malaysia for example, practices a mixed legal system. One legal system is based on the UK legal system familiar to those from common law jurisdictions whilst the other legal system comprises Islamic law and customary law.

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<sup>25</sup> Cheraghlu AM “Islamic Finance and Financial Inclusion: A Case for Poverty Reduction in the Middle East and North Africa?” <http://blogs.worldbank.org/arabvoices/islamic-finance-and-poverty-reduction> (accessed 19 December 2018)

<sup>26</sup> Kareem, Muritala, Kewuyemi “Islamic Banking and the question of Secularism in Nigeria” (2016) Volume 6 No.1 *Ilorin Journal of Religious Studies* 77 at 99

<sup>27</sup> “*Takaful* and conventional insurance at first glance may look similar, in that they both share the objective of protection against financial loss, but when taking a closer look, the differences become apparent.” <https://home.kpmg.com/za/en/home/insights/2016/08/takaful-same-but-different.html> (accessed 17 May 2017)

<sup>28</sup> Hussain M, Shahmorad A and Turk R “An Overview of Islamic Finance” <https://www.imf.org/external/pubs/ft/wp/2015/wp15120.pdf> (accessed 7 March 2017)

In South Africa, this creates a situation whereby South African legislators have not contemplated concerns which may arise from the adoption of such an institution and which may fall outside the institution of control found in governance. This may lead to abuse and mismanagement wreaking havoc upon poorer communities in a similar way as a pyramid scheme and the recent financial crisis which began in the United States of America (USA).

The Constitution of the Republic of South Africa, 1996 (hereinafter referred to as the Constitution) upheld the right of communities to develop customary law, subject to the constitutional values of equity and non-discrimination. In terms of Section 9 of the *Constitution*, the state may not unfairly discriminate directly or indirectly against anyone on one or more grounds, including race, gender, sex, pregnancy, marital status, ethnic or social origin, colour, sexual orientation, age, disability, religion, conscience, belief, culture, language and birth. The commitment to equality is fundamental to the new constitutional order. The reason for recognition of the right to equality is to be focused on unjust supremacy by stronger contracting parties to the detriment of weaker contracting parties. South Africa is both a religious and culturally diverse country which can only flourish where all religions, cultures and other systems of belief are accorded an equal measure of protection and recognition by all organs of state.

The recognition of the customary law by the *Constitution* and in particular the entrenchment of the right to culture has created a new dimension to the question about the application of customary law and the related issues of its conceptualization, ascertainment and proof in courts.<sup>29</sup> For example in the case of *Bhe v The Magistrate, Khayelitsha*<sup>30</sup> the court refused to develop the customary law of intestate succession on an ad hoc basis. The Court held that

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<sup>29</sup> Chuma H & Craig B “The Application of African Customary Law under the Constitution of South Africa: Problems solved or just the beginning?” (2000) 117 (2) at *SA Law Journal* at 306

<sup>30</sup> *Bhe v The Magistrate, Khayelitsha* 2005 (1) SA 580 (CC); 2005 (1) BCLR 1 (CC)

the problem with development by the courts on a case by case basis is that changes will be very slow; uncertainties regarding the real rules of customary law will be prolonged and there may well be different solutions to similar problems. The lack of uniformity and the uncertainties it causes is obvious if one has regard to the fact that in some cases, courts have applied the common law system of devolution of intestate estates. Magistrates and courts responsible for the administration of intestate estates would also tend to adhere to formal rules of customary law as laid down in decisions such as *Mthembu* and its predecessors.<sup>31</sup> This case marked a positive turning point in customary law reforms in South Africa.

Throughout the years in which the customary law was recognised as part of the official state law, it was, however, never seen as equal to common law. The Western common law is the dominant law in South Africa and customary law is seen as the inferior law.<sup>32</sup> The classifications of the common law are used to explain customary law. However, the common law is most often considered as the chosen law when there is a conflict of laws between common law and customary law. There is a need for the executive and parliament to ensure the minority beliefs are legislated for, against creating tension between the interests of the majority.

Currently in South Africa, there is a plurality of unofficial laws which include the laws of the Hindu, Jewish and Muslim religions as well as the so-called living customary law and the people's law.<sup>33</sup> The *Constitution*, apart from introducing a new political and constitutional order in South Africa, gave rise to renewed interest in comparative law and the reception of foreign systems.<sup>34</sup>

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<sup>31</sup> Ibid

<sup>32</sup> Ntlama N "The Application of Section 8(3) of the Constitution in the Development of Customary Law Values in South Africa's New Constitutional Dispensation" (2012) 15 1 at 25

<sup>33</sup> Coertzen P "Constitution, Charter and religions in South Africa" 2014 (Chapter 7 Vol 1) AHRLJ 8

<sup>34</sup> H Goitom "The Impact of Foreign Law on Domestic Judgments: South Africa" <https://www.loc.gov/law/help/domestic-judgment/southafrica.php> (accessed 29 July 2017)



Sec 39 (1) (b) of the *Constitution* recognises the difference between international and foreign law. Whilst it recognises foreign law, courts need only consider and are not obligated to apply foreign law. In South Africa, our courts have looked to foreign law for direction and enlightenment but acknowledged that caution must be exercised when considering foreign law. This is because, just like Islamic law, different contexts were used when constitutions were drafted. The different social arrangements and background of foreign countries are different from that of South Africa.

The recognition of Islamic insurance and banking within South African law presents conceptual challenges and policy dilemmas. South African law and Islamic law are different and each system has a distinct legal and social historical foundation. The interest based legislative framework of South Africa is not aligned with the principles that are under the Islamic financial system. Based on these differences the justification for recognising law in one dimension cannot be transferred automatically to another.

### 1.3 THE AIMS AND OBJECTIVES OF THE STUDY

#### 1.3.1 General

#### 1.3.2 Assess the accommodation, recognition and application of Islamic law of *Takaful* into the South African legal system.

##### 1.3.1 Specific Objectives:

4. To describe and evaluate the legal framework of Islamic law.
5. To describe and evaluate the principles of *Takaful*.
6. To identify and discuss the principles of South African law which can have implications on *Takaful*.
7. To analyse contracts that are prohibited in the Islamic context.
8. To discuss the definitions and key aspects of South African Insurance law.
9. To analyse the recognition, accommodation and incorporation of *Takaful* in South Africa.

10. To establish the emerging challenges and make necessary recommendations.

### **1.3.2 Hypothesis:**

- a) The South African legal system is very different from the system in which Islamic finance and insurance were created to operate.
- b) The South African legal system provides for the recognition of Islamic law but the system has many limitations.
- c) The Constitution of South Africa allows for the freedom of religion and trade but freedom of religion is legitimately limited and is not absolute.

### **1.3.3 Research Questions:**

1. What is Islamic law and *Takaful*?
2. What are the products available to the Islamic insurance market in comparison to that of the South African insurance market?
3. Is Islamic law recognised in South Africa?
4. Is Islamic law compatible with South African law?
5. How do you adopt an institution from a foreign system of law into South African law?
6. How do you accommodate the Islamic law institution of *Takaful* in South African law?

## **1.4 METHODOLOGY**

### **1.4.1 Literature Review**

The study shall comprise desk research which will be based on textbooks, journal articles and other literature on South African Law. The research will focus particularly on legislation, regulations, precedents and long held practices that has become part of law and which impact on Insurance law, the incorporation of foreign law into our law as well as rules of interpretation.

#### **1.4.2 Proposed Paradigm**

For the purpose of this study a qualitative paradigm will be followed. This research is concerned with understanding the processes, social and cultural contexts which underlie various behavioural patterns. This research studies systems by interaction and observation and by also focusing on their meanings and interpretations. This research is suitable because it intends to develop and understand how Islamic law is accommodated in South African law.

#### **1.4.3 Limitations**

There is a lack of appropriate and relevant research on the identifying how the practice of *Takaful* may be incorporated into South African law. Due to the limitations of time and financial and manpower resources, this research has been limited in several respects. It is limited in scope to focus on primarily desk research and a limited field research through mail questionnaires of 5 people selected on a convenience sample basis. It does not seek to cover the topic comprehensively but it is instead exploratory in nature with a view toward provoking further question as that will arise which may form the subject for the research. The interviewees will be selected primarily from the practitioners in the South African Insurance industries who deal with *Takaful* and will not be necessarily be technically qualified people in law and the economic sciences who will rather be people that are involved in the partial aspects. The desk research will provide the legal technical and other technical information pertaining to the application of *Takaful* in South African law.

A further limitation is that the sample is taken from a particular location and the research has been conducted within the Gauteng area. Accordingly, the findings of this research will not be representative of all South African citizens

It is envisaged that the study will contribute to the knowledge about *Takaful*, its application and the requirements for it to meet the needs of practice and adoption in South African Law. It will be of value to Insurance legislators, companies, future research and will assist them with accessibility of

information, conflicts and different legal systems. This will also enable the industry to understand and relate to the conflicts of the Muslim community in relation to South African legal regime.

The legal framework of Islamic and conventional insurance is important for defining the characteristics of contracts and their enforcement. Thus, it helps in the development and introduction of new financial products. With the rapid development of the Islamic banking and finance in South Africa, the law must also be able to keep up with the speed of such development. Thus the study of development of legal regime becomes an important area to aid and assist legal practitioners in identifying and resolving legal disputes.

Wherever in this dissertation, there is a reference to the Prophet Muhammed, the Islamic tradition would require that his name should be stated as “The Holy Prophet Muhammed (May peace be upon him).” In this dissertation, the practice has not been employed throughout, on account of the fact that it causes tedious repetition and that it is not consistent with the objective nature of research, which has to find an appeal to an audience of people from diverse benefits or lack of beliefs.

#### **1.4.4. Scope of Study**

This study is composed of six chapters. Besides the introductory chapter which constitutes chapter one, it contains five other chapters. Chapter two gives an analysis of the historical legal background of Islamic law, Islamic law principles, contracts and the prohibitions in Islamic law. This chapter provides a literature survey of Islamic law products in particular as well as the interest-free and non-gambling requirements.

Chapter three will examine the principles, objectives, elements and the operation of Islamic insurance known as *Takaful*. To examine the meaning, scope and regulatory framework of *Takaful* internationally. The analysis is done by looking at the world’s largest *Takaful* market in the world in Malaysia.

Malaysia has a dual banking system which means that conventional insurance and Islamic insurance operate side by side.

Chapter four deals with the definitions and key aspects of South African law of insurance. In order to determine how *Takaful* may be accommodated in South African Law, the different types of insurance policies as well the legislation governing these instruments are analysed and described.

In chapter five of the proposed study, I will analyse the recognition of cultural diversity in the 1996 Constitution of the Republic of South Africa. The Constitutional right to freedom of religion and other provisions in the South African Constitution which are conducive to the adoption of Islamic law are considered. The chapter also analyses the role and impact of the judiciary in the law-making process in South Africa. Finally chapter six presents the Summary and Recommendations.

## **1.5 Chapter Conclusion**

In this interconnected world marked by revolution and increased complexity, strong financial regulation is crucial. Currently, South Africa has a very avant-garde and pioneering financial, legislative and governance structures for the conventional financial and insurance industry.<sup>35</sup> The Islamic banking and insurance industry has however spiralled in the South African market and is also in a great need for adequate regulation and supervision.<sup>36</sup> The next chapter presents the legal framework governing Islamic banking and finance, corporate governance, Islamic contracts and products. The growth and

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<sup>35</sup> "Financial sector regulation and reform"

<http://www.treasury.gov.za/documents/national%20budget/2016/review/Annexure%20d.pdf>

(accessed 7 July 2017)

<sup>36</sup> "Institute of Islamic Banking and Insurance" <http://www.islamic-banking.com/islamic-finance.aspx> (accessed 29 September 2017)

development of Islamic banking industry is unquestionably dependent much by having a comprehensive legal framework.

## CHAPTER TWO: THE LEGAL FRAMEWORK GOVERNING ISLAMIC TRANSACTIONS

### 2.1 Introduction

Islamic law represents one of the world's great legal systems.<sup>37</sup> The legal system defines a set of rules, conduct and procedures which are necessary to regulate and maintain a disciplined society. In order to establish landmarks for external relationships, the Islamic legal system provides for manifold rules. In understanding Islamic finance, it is important to start with a brief overview of Islamic law because Islamic finance is the application of Islamic law to financial and commercial transactions. This chapter presents an overview of Islamic law, the rules for Islamic banking, corporate governance, Islamic contracts and products. All Islamic rules are consistent and guided by Islamic law. Islamic contracts are subject to clear regulations under Islamic *Shariah*. Religious teachings had an evident effect on the emergence of contracts based on three fundamental prohibitions: *Riba, Gharar, and Maysir*. The prohibitions will be discussed below.

The products of Islamic finance, in general, are described in this chapter to provide an understanding of the interest-free principles of Islamic law application in practice and in particular how the mechanisms and logic are employed in the formation of contracts.

### 2.2 The Application of Islamic (*Shariah* law)

Islamic law is often at times used as a synonym for *Shariah*. *Shariah* is a law, which comprises a body of religious, social and legal requirements. The origins of *Shariah* are based on the direct command of God (Allah) and the practice of the Prophet Muhammad (*Sunnah*). There are also provisions or powers, given to man to interpret and expand the divine commands. Islamic

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<sup>37</sup> David R, John E. C. Major B "Legal Systems in the World Today: An Introduction to the Comparative Study of Law" (1978) at 437.

Interpretations are done by means of analogical deduction<sup>38</sup> and through other processes. Unlike Roman law, which developed from an action, or English common law, which developed from writs,<sup>39</sup> *Shari'ah law* developed from the primary sources which are, the noble Quran<sup>40</sup> and *Sunnah* of Prophet Muhammad. Prophet Muhammed stated: "*I leave two things amongst you and you will never go astray whilst holding them firmly, they are, the book of Allah and the Sunnah of his Prophet.*"<sup>41</sup> The secondary sources are the consensus (*ijma*) of learned men, jurists (*ulama*) and analogical deduction (*qiyas*). The analogical deduction is recognised as a legitimate source of the Islamic legal system because it provides as an instrument to cope with the growing needs of society. These sources provide a detailed understanding of the Quran and the *Sunnah*. The *Shari'ah* also takes into consideration judicial preference (*istihsan*).<sup>42</sup> Judicial preference helps in providing elasticity and adaptability in the Islamic legal system. The fundamental laws and rules of Islam that are laid down in the Quran and the *Sunnah* are unchangeable. Therefore, all theories and practices, covered in the field of economics and law, are examined from the Islamic perspectives and values as enshrined in the Quran and the *Sunnah*

### **2.3 The Brief History of Islamic law**

Islamic banking was first established in the city of Ghamr Egypt, as a small-scale pioneering experiment, and has become one of the fastest growing industries. The Mit Ghamr Savings Bank, which was under the leadership of Dr EL Naggar, aimed to attract small savings and support investments of a

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<sup>38</sup> Hassan MK and Lewis MK *Handbook of Islamic Banking* (2007) Edward Elgar Publishing Limited.

<sup>39</sup> Coulson NJ *A History of Islamic Law* (1994) Edinburgh University Press at 8.

<sup>40</sup> Muhammad H *Muslim Conduct of State* (1973) at 12

<sup>41</sup> *Hadith at-Thaqalayn* 3786, Volume 6, Chapter 31

<sup>42</sup> See, a guide to Islamic finance in and from the Dubai international financial centre (2007)



productive character on a profit sharing basis.<sup>43</sup> In 1967, the Mit Ghamr Savings Bank was closed due to political reasons.<sup>44</sup> However, the idea and concept of an interest-free banking system spread amongst the Muslim leaders. This led to the development of various interest-free banks such as the Dubai Islamic Bank.<sup>45</sup> The Dubai Islamic Bank has now become the largest Islamic bank in the world.<sup>46</sup>

The concept of Islamic banking has become the epitome of the Middle Eastern countries. This concept spread throughout the world especially in South East Asia, where Malaysia plays a significant role in the development of regulations pertaining to modern day of Islamic banking. Since the establishment of Islamic banking, it was considered a niche player which caters to the special needs of Muslims.<sup>47</sup> One of the reasons that the western communities and academics have shown interest to contribute and research the Islamic banking system is because the system rejects the western interest-based banking system. This rejection is beneficial to Muslims and non-Muslims alike. The Islamic insurance markets conduct themselves ethically and in accordance to *Shariah* law. The Malaysian legal system includes legislation such as the Islamic Banking Act of 276 of 1983, The *Takaful* Act 312 of 1984, Islamic Security Commission Act of 1993, Central Bank Act of 2003 and the Islamic Financial Services Act 759 of 2013.

## 2.4 The Principles of Islamic Banking and Finance

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<sup>43</sup> Ohan ZH Mit Ghamr Savings Bank: A Role Model or an Irreplicable Utopia?

<sup>44</sup> Munawar I and Molyneux P "Thirty years of Islamic banking" (2005) at 1

<sup>45</sup> "Islamic banking and finance, is today one of the world's fastest-growing economic sectors that comprises of more than 400 institutions tasked with managing assets in excess of US\$ 1 trillion globally." <http://www.dib.ae/home> (accessed 16 May 2017)

<sup>46</sup> Belhoul S "Dubai Islamic Bank"  
[https://www.symantec.com/content/en/us/enterprise/customer\\_successes/b-dubai\\_islamic\\_bank\\_CS.en-us.pdf](https://www.symantec.com/content/en/us/enterprise/customer_successes/b-dubai_islamic_bank_CS.en-us.pdf) (accessed 29 September 2017)

<sup>47</sup> Vawda M Islamic banking in South Africa: An exploratory study of Perceptions and Bank Selections Criteria among chartered accountants in South Africa 2014

An Islamic bank is an institution, which mobilises financial wealth and lays out this wealth with the expectation of attaining an Islamic, tolerable, communal and financial purpose.<sup>48</sup> Rodney Wilson<sup>49</sup> asserts that ultimately Islamic banking and finance is about the emergence of a distinctively Islamic form of capitalism that may co-exist and interact with the Western, Chinese, Russian or any capitalism.<sup>50</sup> This development should be welcomed and facilitated and not hindered and suppressed.<sup>51</sup>

Under Islamic banking, the mobilisation and investment of wealth is expected to be managed in a manner conforming to the principles of *Shariah*.<sup>52</sup> The Islamic principles of finance relates to the ideas of the prohibition against charging and receiving interest, ethical standards, moral and social values and the concept of fairness.<sup>53</sup> The first and most important principle in Islamic economics is the prohibition against interest, which is strictly forbidden in Islam. Islamic banking is based on interest-free transactions, which is founded, not on interest, but on sharing of profit and losses.<sup>54</sup> The second principle relates to the ethical standards.<sup>55</sup> In temporal communities, legal

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<sup>48</sup> An Islamic bank must conform to the principles of *Shariah* which involves the prohibition of interest, ethical standards, moral and social values and liability and risk management <http://www.albaraka.com> (accessed 8 September 2014)

<sup>49</sup> Rodney Wilson: "Islamic Banking: an opportunity or threat" (2007) <http://www.commongroundnews.org/article.php?id=20284&lan=en&sp=> accessed (15 October 2014)

<sup>50</sup> See remarks by Rodney Wilson: "Islamic Banking: an opportunity or threat" (2007) <http://www.commongroundnews.org/article.php?id=20284&lan=en&sp=1> (accessed 15 October 2014)

<sup>51</sup> Ibid

<sup>52</sup> Ibid

<sup>53</sup> Principles of Islamic banking <https://www.albaraka.com> (accessed 20 December 2018)

<sup>54</sup> Profit and loss sharing (PLS) Modes of financing <https://www.albaraka.com> (accessed 20 December 2018)

<sup>55</sup> Ethics may be defined as the set of moral principles that distinguishes between what is right and wrong. It is a normative field because it prescribes what one should do or abstain from

interpretations are constructed upon contemporary and often short-term ephemeral values and merits.

Rafik Issa Beekum <sup>56</sup>points out that the Islamic ethical system differs from secular ethical systems and from the moral codes advocated by other religions.<sup>57</sup> He adds that throughout history, these secular models assumed moral codes based on values of human founders which were divorced from religion. Islamic codes are not time-bound or based on the opinions of man.<sup>58</sup> The Islamic ethical system is based on equity and fairness and is enforceable at all times because it is the law of God.<sup>59</sup>

In an Islamic community, the values identified by Beekum and merits are controlled by the *Shari'ah* and the accumulation of prior *Fiqh*<sup>60</sup>rulings. Upon the conclusion of an investment transaction, it is the Islamic duty of Muslims, to ensure that their investments are not unlawful and prohibited in Islam. Therefore Islamic investments also include careful deliberation of the investments, policies, products, services and the impacts that these have on a community and the environment.

The third principle pertains to moral and social values. Muslims and the organisation they work for, are expected to care for the welfare of the society

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doing. For more reading on Islamic business ethics, see *Rafik Issa Beekum Islamic Business Ethics* (2004)

<sup>56</sup> *Rafik Issa Beekum Islamic Business Ethics* (2004)

<sup>57</sup> *Ibid.*

<sup>58</sup> *Rafik Issa Beekum Islamic Business Ethics* (2004)

<sup>59</sup> *Ibid.*

<sup>60</sup> The *Shariah* presents clear guidance on the five categories of *fiqh* which are the obligatory, recommended, permissible, disliked and forbidden and is based on the teachings of the Quran and the *Sunnah*. Allah decides what is obligatory, recommended, permissible, disliked and forbidden. No one but Allah and the Prophet has authority to declare any food, drink, trade or business unlawful. This is declared in Quranic injunctions and the revelations through the Prophet

they live in. Some Muslims businesses contribute to charity but all modern Islamic financial institutions have apportioned the concept of profit-free loans known as the *Al Qard Al Hasan*.<sup>61</sup>This profit-free loan helps Muslims by providing profit free finance for marriages, medical treatment, and education tuitions.

The final principle analyses liability and risk management with the all-embracing notion of fairness. This entails the prohibition of speculative contracts, sanctity of contracts and only investments that do not violate the rules of *Shariah* are permissible. This principle is derived from a saying of the Prophet "profit comes with liability."<sup>62</sup>This interpretation means, that one becomes eligible to profit only when one becomes accountable for the risk of loss.<sup>63</sup>

The connection between profits with the possibility of loss enables Islamic law to recognise lawful profit from all other structures of benefits.<sup>64</sup> Islamic finance is therefore based on principles of fairness, justice and equality by promoting trade and prohibiting usury and uncertainty. In comparison to conventional finance, Islamic finance is for the welfare of society, secure, equal and freely obtainable.<sup>65</sup>

However, the implementation of conventional governance and Islamic governance are relatively alike.<sup>66</sup>*Shariah* Governance has promoted much

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<sup>61</sup> Z Lutfiah "The Effectiveness of interest Free loan financing (Qardhul Hasan) As the social implementer of Islamic Bank to Reduce Poverty in Surakarta" (2017)

<sup>62</sup> Dr S. A. Chintaman "A Comparative Study of CSR Practices of Islamic Banks and Conventional: Banks in GCC Region" *Journal of Islamic Banking and Finance* at 6

<sup>63</sup> Ibid

<sup>64</sup> See Hassan (2007)

<sup>65</sup> Usmani MT Introduction to *Islamic finance* (2011) at 196

<sup>66</sup> Kasri R Center of Islamic Economics and Business, Faculty of Economics and Business University of Indonesia (PEBS-FEUI) (2009)

attention in the literature of Islamic banking industry therefore the study intends to give a brief overview of governance.<sup>67</sup>

## **2.5 The Principles of Corporate Governance in Islamic law**

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<sup>67</sup> Mizushima T Corporate Governance and *Shariah* Governance at Islamic Financial Institutions: Assessing from Current Practice in Malaysia *Reitaku Journal of Interdisciplinary Studies* Vol. 22, No. 1

According to the Organization for Economic Co-operation and Development (OECD), corporate governance is described as ‘a set of relationship between company’s management, its board, its shareholders and other stakeholders.’<sup>68</sup>

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<sup>68</sup> Definition of corporate governance by the Organisation for Economic Co-Operation and Development <http://oecd.org/corporate/ca/corporategovernanceprinciples/3133574.pdf> (accessed 26 November 2014)

Corporate governance plays an essential function to provide the structure through which the company goals are set and the means of attaining those objectives and monitoring performance are determined.<sup>69</sup> Good corporate governance plays a significant role for stakeholders in the business industry. The goal of corporate governance differs from one company to another and from one country to another. Matters of common interest between countries and companies are to motivate a good code of processes and to uplift and govern the organisation. The principles of good business conduct are desirable because it allows for the protection of investor interests and enhances the integrity of the institutions. Islamic banks, like conventional banks, have a duty to maintain good corporate governance practices and to protect their client's interests. It is also an important requirement under *Shariah* law for companies to observe principles of ethical business conduct. Additionally, the propositions of confidence and transparency strengthen the robustness of a *Shari'ah* compliant contract.<sup>70</sup>

In the Islamic banking industry regulations are required to maintain confidence in the system, to protect the interests of shareholders and to ensure the safety and soundness of the financial system.<sup>71</sup> Islamic banks can be guided by standards provided for by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)<sup>72</sup> and the Islamic Financial Service Board (IFSB).<sup>73</sup> The Islamic Financial Services Board serves as 'an

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<sup>69</sup> Ibid

<sup>70</sup> See, Clayton J "Principles of Corporate governance" (2009) <http://www.nortonrosefulbright.com/knowledge/publications/19472/islamic-finance-corporate-governance-briefing> (accessed 27 November 2014)

<sup>71</sup> Islamic Financial System [www.islamic-banking.com](http://www.islamic-banking.com) (accessed 20 December 2018)

<sup>72</sup> The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and *Shari'ah* standards for Islamic financial institutions and the industry <http://www.aoifi.com/en/about-aoifi/about-aoifi.html> (accessed 26 November 2014)

<sup>73</sup> The Islamic Financial Services Board (IFSB) has issued twenty-seven Standards, Guiding Principles and Technical Note for the Islamic financial services industry. This a treaty based

international standard-setting body of regulatory and supervisory agencies.’ They have a vested interest in ensuring the soundness and stability of the Islamic financial services industry, which is defined broadly to include banking, capital market and insurance.”<sup>74</sup>

The Islamic Financial Services Board has published draft standards dealing with the Core Principles for Regulation (CPIFR) and supervision of the industry. The main objective of the draft publication is to provide a set of core principles with associated assessment methodology for the regulation and supervision of the Islamic Financial Services Industry (IFSI). <sup>75</sup> Special consideration will be given to the specificities of the International Islamic financial services industry (IIFS), the lessons learned from the financial crisis and complementing the existing international standards.”<sup>76</sup>

The organisational strategies for the practice of good corporate governance as presented by the Islamic Financial Services Board include; <sup>77</sup>

- a) The interests of its stakeholder.
- b) The providing of appropriate incentives for the board of directors, *Shari’ah* supervisory board and the management.
- c) To being impartial to the interest of the stakeholders and to aid in useful monitoring, this will inspire institutes offering Islamic financial services to utilize resources productively.

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institution which has international personality in terms of an Act of Parliament in Malaysia. <http://www.ifsb.org/> (accessed 26 November 2014)

<sup>74</sup> Background of the Islamic Financial Services Board <http://www.ifsb.org/background.php> (accessed 26 November 2014)

<sup>75</sup> Islamic financial Services Board organises public hearing on exposure drafts for Islamic Finance regulation and guidance note on liquidity risk management [http://www.ifsb.org/press\\_full.php?id=278&submit=more](http://www.ifsb.org/press_full.php?id=278&submit=more) (accessed 27 November 2014)

<sup>76</sup> Ibid

<sup>77</sup> Islamic financial Service Board “Guiding principles on corporate governance for institutions on corporate governance for institutions offering only Islamic financial services.” (2006) <http://www.ifsb.org/standard/ifs3.pdf> (accessed 5 May 2015)



d) The compliance with Islamic *Shari'ah* rules and principles.

The IFSB has marked the evolution of a higher level of corporate governance by creating and agreeing on standards of capital adequacy and risk management. It aims at modelling the current international standards and for institutions to support the view that compliance is imperative to maintain desired corporate governance.<sup>78</sup>

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)<sup>79</sup> is one of the most important and powerful Islamic national authority which is based in Bahrain. This institution was established to maintain and promote *Shari'ah* standards for the Islamic financial industry. The governance standards include the appointment and composition of a *Shari'ah* Supervisory Board, audit and governance committee for Islamic financial institutions and disclosures for Islamic financial institutions.

The important element of the corporate governance framework for Islamic banks is the *Shari'ah* Supervisory Board and the internal controls which support it.<sup>80</sup> All Islamic Financial Institutions are required to have a *Shariah* Supervisory Board (council of jurists). The *Shariah* board consists of well-versed Muslim scholars who are highly qualified to issue religious rulings (*fatwa*) on financial transactions. They have considerable experience and expertise in financial dealings and transactions which enable them to

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<sup>78</sup>Islamic Finance Corporate Governance  
<http://www.nortonrosefulbright.com/knowledge/publications/19472/islamic-finance-corporate-governance-briefing> (accessed 27 November 2014)

<sup>79</sup>The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) develops accounting, auditing, governance and ethical thought relating to the activities of Islamic financial institutions taking into consideration the international standards and practices which comply with Islamic *Shariah* rules <http://aaoifi.com/objectives/?lang=en> (accessed 29 September 2017)

<sup>80</sup> Duties and responsibilities of the *Shari'ah* Committee  
<http://www.muamalat.com.my/downloads/corporate-overview/Duties-and-Responsibilities-of-the-Shariah-Committee.pdf> (accessed 6 May 2015)

supervise Islamic banks activities.<sup>81</sup> A *Shariah* Board also provides guidance for the bank's practices and advises on the management's adherence to high standards of ethical, social and *Shariah* commitments. The rulings of the *Shariah* board are binding on the institution and this may be a disadvantage of *Shariah* because Islamic law is highly interpretive and precedents are not binding in Islamic law. Therefore different boards may have different opinions or interpretations.<sup>82</sup>

Islamic corporate governance is similar to the conventional theories of corporate governance but Islam furthers the framework by underlining the factors of faith, *Shari'ah*, value and ethics as essential elements to abide by.<sup>83</sup> The existence of ethical principles based on modern practice is relevant to the consideration of whether Islamic law of Insurance can fit into South Africa's legal practice. The objective of Islamic companies is to structure Islamic products that have a similar risk-return feature of western products. Legally this is done by using legitimate Islamic contracts. The chapter below shall provide a brief introduction to various notions of Islamic contracts as they exist today.

## **2.6 The Principles of Islamic Contracts**

Islamic commercial law encourages sanctity of contracts and the engagement in business activities.<sup>84</sup> In accordance with tradition, Anglo-American common law did not consider principles of fairness of a contract but in modern times

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<sup>81</sup> Safian DM *Shariah Scholars and Fatwa making process in Islamic finance* [https://www.academia.edu/20367500/sharia\\_scholars\\_and\\_fatwa\\_making\\_process\\_in\\_Islamic\\_finances](https://www.academia.edu/20367500/sharia_scholars_and_fatwa_making_process_in_Islamic_finances) (accessed 21 January 2019)

<sup>82</sup> *ibid*

<sup>83</sup> Hasan Z "Corporate Governance in Islamic Financial Institutions: An ethical perspective" (2012) *Prime Journals of Business Administration and Management* at 7

<sup>84</sup> Contracts in Islam <http://www.financialislam.com/islamic-commercial-contracts.html> (accessed 8 January 2018)

the common law is closer to Islamic law.<sup>85</sup> An Islamic contract has been defined as an agreement whereby one party in return for a consideration undertakes to pay other party, the sum of money or its equivalent in kind on the happening of a specified event.<sup>86</sup>

The only prohibitions which may be introduced to limit Islamic contracts include interest, speculative trading and any form of gambling. If any contract contains Islamic prohibitions, the contract is void. In South Africa, mora interest constitutes a form of damages for breach of contract. The general principle in the assessment of such damages is that the sufferer by the breach should be placed in the position he would have occupied had the contract been performed.<sup>87</sup> Judicial officers in South Africa will face challenges when called upon to apply or interpret Islamic law contracts.<sup>88</sup>

The discussion below deals with a brief discussion of the Islamic contract in order to establish the elements applicable to an Islamic contract and the position of Islamic contracts in relation to South African contractual law.

### **2.6.1 Elements of an Islamic contract**

A contract in Islam is valid if all elements are complied with, performance has been done and if it does not imply interest, uncertainty or speculation.

#### **2.6.1.1 Consideration**

In terms of Shari'ah law, a contract is entered into when one party makes an offer to another party for some consideration and the offer is accepted by the

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<sup>85</sup> Ahmed S *Islamic banking finance and insurance: A global overview Basis of Islamic finance* (2009) at 15

<sup>86</sup> Hassan, Kayed and Oseni "Introduction to Islamic Banking and Finance: Principles and Practice" (2013) at 47

<sup>87</sup> "Common law right to claim interest." De Rebus, Jan/Feb 2014:20 [2014] Derebus 43

<sup>88</sup> *Lodhi 5 Properties Investments CC v FirstRand Bank Limited* [2015] 3 All SA 32 (SCA) and the Enforcement of Islamic Banking Law in South Africa

other party. The offer must not be made under duress, the consideration must be lawful and the parties must be in agreement about the performance. This is an essential element of a contract, therefore, impossibility to perform renders, the contract invalid. The consideration must be lawful therefore if the contract offers wine or pork such contract is unlawful.<sup>89</sup>

### 2.6.1.2 Offer and Withdrawal

An offer can be made verbally (bi'l Kalam), in writing (bi'l kitabah) and can be made through a message sent by a person whose honesty cannot be doubted (rasul), through signs and gestures and by means of conduct. The period between making an offer and its acceptance is called Majlis al-'aqd which means the sitting for the contract. There are different viewpoints on the withdrawal of an offer.<sup>90</sup> According to the Hanbali <sup>91</sup>school of thought, a person who has made an offer has the right to retract the offer before such offer is accepted, whilst the Maliki <sup>92</sup>school of thought is that once an offer has been made, such offer cannot be retracted.<sup>93</sup>

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<sup>89</sup> Rahman AL and Clarke A 'Shariah: Islamic law' (2008) at 551

<sup>90</sup> Rahman D Khiyar Al-Majlis (Option of Withdrawal before Parting) in Sale Contract Contemporary Applications [https://www.academia.edu/34670706/Khiyar\\_Al-Majlis\\_Option\\_of\\_Withdrawal\\_before\\_Parting\\_in\\_Sale\\_Contract\\_Contemporary\\_Applications](https://www.academia.edu/34670706/Khiyar_Al-Majlis_Option_of_Withdrawal_before_Parting_in_Sale_Contract_Contemporary_Applications) (accessed 21 January 2019)

<sup>91</sup> Islamic school of legal thought (Madhhab) whose origins are attributed to Ahmad ibn Hanbal in ninth-century Baghdad. The official school in Saudi Arabia and Qatar, with many adherents in Palestine, Syria, and Iraq. Recognizes as sources of law: the Quran, hadith, fatwas of Muhammad's Companions, sayings of a single Companion, traditions with weaker chains of transmission or lacking the name of a transmitter in the chain, and reasoning by analogy (qiyas) when absolutely necessary. Encourages the practice of independent reasoning (ijtihad) through study of the Quran and hadith. Rejects taqlid, or blind adherence to the opinions of other scholars, and advocates a literal interpretation of textual sources. Ritually, the Hanbali School is the most conservative of the Sunni law schools, but it is the most liberal in most commercial matters. <http://www.oxfordislamicstudies.com/article/opr/t125/e799> (accessed 2 December 2014)

<sup>92</sup> The collection and codification of Islamic law has historically been one of the most important, and challenging, tasks that the Muslim community has undertaken in 1400 years of history. To be considered a *faqih* (an expert in Islamic law – *fiqh*), one must have mastery of the Quran, the sayings of Prophet, other sources of law, as well as other subjects such as grammar and history. One of the giants of Islamic law was the 8th century scholar of Madinah, Malik ibn Anas. At a time when the Muslim community desperately needed the sciences of fiqh and hadith (sayings and doings of Prophet to be organized, Imam Malik rose

### 2.6.1.3 Competency of the parties and the Termination of a contract

The parties to a contract must have the legal capacity to enter into a contract. A minor, slave, insolvent person, intoxicated person, a person of unsound mind and a terminally ill person are excluded from being parties to a contract.<sup>94</sup> A contract may be terminated by an agreement between the parties or according to the contractual terms. If the contract is void, which is in circumstances whereby consent was obtained by coercion, undue influence, fraud, misrepresentation or a mistake then the innocent party has an option to cancel such agreement.<sup>95</sup>

### 2.6.2 Unlawful contracts in Islam

Islamic economics encourage Muslims to engage in lawful trade and commercial activities and these activities are to be conformed to the boundaries of being permissible (*halaal*)<sup>96</sup> or forbidden (*haram*).<sup>97</sup> This entails that Muslims are obligated to comply with *Shari'ah* law, which requires justification for profit and guarantees the prohibition of interest.<sup>98</sup> The purpose

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to the occasion. His legacy is manifest in his continued influence throughout the Muslim world, both through his own works and the works of those he helped guide on a path of scholarship and devotion to Islam. <http://lostislamichistory.com/tag/maliki/> (accessed 2 December 2014)

<sup>93</sup> See Abd ar-Rahman (2008) at 552

<sup>94</sup> See Abd ar Rahman (2008) at 552

<sup>95</sup> See Abd ar Rahman (2008) at 552.

<sup>96</sup> *Halaal* originates from an Arabic phrase that means allowed or permitted by Islamic Law.

<sup>97</sup> *Haram* earnings include trading in alcohol, drug dealing and trading, prostitution and any kind of trade involving uncertainty. *Shari'ah* prohibits earnings of such haram income, usury, gambling, hoarding and deceptive purchases.

<sup>98</sup> See Qasaymeh K (2011) at 275-292

of the system of *halaal* and *haram* is to give direction to the Islamic society and is also intended on giving value to Islamic legal frameworks.<sup>99</sup>

The Islamic economic regime revolves around the prohibition of the principles speculation, gambling, and interest.<sup>100</sup> Islamic law prohibits interest (*Riba*) because this practice is a form of exploitation especially to the poor debtor by the rich creditor. Interest (*Riba*) is in fact just a form of uncertainty (*Gharar*).<sup>101</sup> Uncertainty opens the door for speculation, ruthless greed, immorality, and social decay, inflation, volatility, unemployment, instability, and environmental degradation are the negative consequences of interest and uncertainty.<sup>102</sup>

### **2.6.2.1 The prohibition of Interest (*Riba*)**

The man has struggled to liberate himself from the “depression of interest”, this is as old as history itself, and predates even the minting of money.<sup>103</sup> All great religions and philosophers such as Aristotle opposed interest. Judaism, Christianity and Islam prohibit charging interest and consider it as an act of exploitation and extortion. The biblical injunction prohibiting interest is confirmed in the following verse: “*if you lend money to one of my people amongst you who is needy, do not be a moneylender, charge him no interest.*”<sup>104</sup> Whilst the Jewish injunction on the prohibition of interest is as

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<sup>99</sup> Ibid

<sup>100</sup> Interest which means that insurers invest in interest bearing securities and possible interest on loans, or unlawful contracts which is the case when insurers invest in commodities or are involved in activities that are forbidden (alcohol, pork).

<sup>101</sup> Lim H Land, *Law and Islam: Property and Human Rights in the Muslim World* at 223

<sup>102</sup> Paldi C “Understanding *Riba* and *Gharar* in Islamic Finance” (2014) *Journal of Islamic Banking and Finance* at 1

<sup>103</sup> Homer Sidney “*A history of Interest rates*” (1977) at 17

<sup>104</sup> Exodus 2:25 ‘*Bible studies on interest*’ <http://www.biblestudytools.com/topical-verses/money-bible-verses> (accessed 29 May 2013)

follows: “An entrepreneur who lends money with interest will suffer financial reverses.”<sup>105</sup>

One of the fundamental principles of Islamic commerce is the prohibition of interest.<sup>106</sup> *Riba* is translated to mean interest, undue profits or excessive gain from a transaction. The prohibition of receiving and the payment of interest is supported by the principles of the Islamic doctrine which advocate risk sharing, individual rights, duties and the sanctity of contracts. The Islamic economic regime seeks to establish an order where exploitation and injustice are eliminated.<sup>107</sup>

The prohibition of interest is one of the crucial factors that led to the emergence of Islamic banking, which has provided answers not only for the Muslim population but also for those who are looking for a more ethical solution to loan money and to receive loans. Conventionally, when interest is charged on a loan, it is considered as compensation for the period of repayment of the loan. In Islamic law, this period does not form part of a tradable property and as such, the transactions are prohibited. The Quranic point is that any fixed amount paid over the principal amount is an injustice, therefore such loan contract based on interest involves injustice either to the lender or borrower because there is an uneven distribution of risk and benefits.

Islamic finance is based on a shared responsibility for profit and loss between borrower and lender. This means when a person buys shares in a company,

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<sup>105</sup> See remarks by Rabbi Joseph Stem *Jewish law on interest*.

<http://www.jlaw.com/articles/ribis1.html> (accessed 29 May 2013).

<sup>106</sup> The translation of the Arabic verb *Riba* is derived from *Raba* which means increase. *Riba* refers to usury and interest

<sup>107</sup> Has Islam really prohibited interest?

[http://www.albaraka.co.za/Islamic\\_Banking/Prohibition\\_of\\_interest/Has\\_Islam\\_really\\_prohibited\\_interest.aspx](http://www.albaraka.co.za/Islamic_Banking/Prohibition_of_interest/Has_Islam_really_prohibited_interest.aspx) (accessed 16 March 2015)

both the profit and losses of the venture must be shared. Practice among Islamic banks today appears to consider instances whereby credit provider loans money to a creditor and charge fees only for services rendered as *halaal*. The financial gain for the loan is the contract and this forms the basis to calculate the lender's fees which include losses and profits. The service fee is charged only for certainty instead of uncertainty. This is debatable and is considered by some as a disguised form of interest taking.

### **2.6.2.2 Riba in Islamic Banking**

Riba in Islamic banking 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. This definition of Riba Islamic finance is derived from the Quran and is unanimously accepted by all Islamic scholars.<sup>108</sup> There are two types of Riba, identified to date by these scholars namely Riba Al Nasiyah and Riba Al Fadl.

### **2.6.2.3 Riba Al Nasiyah**

Riba al Nasiyah is defined as 'any excess compensation over and above the principal amount which is paid without due consideration.'<sup>109</sup> The act relates to an extension of the repayment period for an additional payment of money. It is also called Riba Jahiliyyah which was a pre-Islamic form of usury and the worst of its kind. This is the primary form of Riba and can be compared to the current lending activities of modern banks. The nature of this prohibition is strict, final and unambiguous.

### **2.6.2.4 Riba al Fadl**

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<sup>108</sup> What is *Riba* in Islamic Banking and Finance? <http://www.aims.education/study-online/riba-in-islamic-banking-and-finance/> (accessed 29 September 2017)

<sup>109</sup> Types of Riba <https://islamicmarkets.com/education/types-of-riba> (accessed 28 January 2019)



Riba al-Fadl means an increase which is taken in exchange of specific homogeneous commodities, such as selling gold with another gold, whereby one has more “weight” than the other.<sup>110</sup> This can be compared to the exchange of commodities contracts in modern time. When compensation is paid it must be justified by a specific activity or risk. Therefore when commodities of a similar value are exchanged, and when a party pays excessive compensation to the other, it is a form of Riba and prohibited in Islam.<sup>111</sup> The prohibition of Riba al-Fadl is intended to ensure justice and remove exploitation through ‘unfair’ exchanges. According to the unanimously accepted legal maxims of Islamic jurisprudence ‘*anything that serves as a means to the unlawful is also unlawful*.’<sup>112</sup>

*Takaful* is governed by the principles of Shariah, where transactions involving Riba, Gharar and Maysir are prohibited. Riba is avoided in *Takaful* using contracts for profit shares rather than fixed interest and investment in Shari’ah compliant schemes. *Takaful* contracts also have to follow specific rules to avoid Gharar.

Riba in Islamic banking 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. This definition of Riba Islamic finance is derived from the Quran and is unanimously accepted by all Islamic scholars.<sup>113</sup> There are two types of Riba, identified to date by these scholars namely 'Riba Al Nasiyah' and Riba Al Fadl.

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<sup>110</sup> Hussein Elasrag *Principals of the Islamic finance: A focus on project finance* (2011) at 15

<sup>112</sup> Hussein Elasrag *Principals of the Islamic finance: A focus on project finance* (2011) at 15

<sup>113</sup> *Riba al Fadl really prohibited interest. asx* ([http://www.albaraka.co.za/Islamic\\_Banking/Prohibition\\_of\\_interest/Has\\_Islam\\_really\\_prohibited\\_interest.aspx](http://www.albaraka.co.za/Islamic_Banking/Prohibition_of_interest/Has_Islam_really_prohibited_interest.aspx)) (accessed 16 March 2015)

### 2.6.2.5 The Prohibition of Uncertainty (Gharar)

One of the fundamental rules of Islamic law is that contracts must be free from speculations or uncertainties.<sup>114</sup> This prohibition is called Gharar.<sup>115</sup> Gharar is one of the major elements of the Islamic law of contracts. This element is also referred to as an unknown outcome or result. The rationale of Gharar is to protect the weak from exploitation and if a contract is uncertain then it is forbidden. However, if there is uncertainty in a contract, which cannot lead to a dispute, there is a valid contract. Islamic law requires that Muslims must avoid unfair dealings resulting from an ambiguous understanding of the rights and duties of contracts. This prohibition is in relation to terms of conditional contracts, for example, “I will sell my house if you sell yours.” The sales are on condition upon each other, therefore there is uncertainty and could lead to an unjust outcome.<sup>116</sup> The Shariah states that it is important to define the elements such as subject matter, delivery and price. If this procedure is followed there will be no disputes since both parties have the knowledge of the counter value<sup>117</sup> that will be exchanged due to the contract.<sup>118</sup>

Under Islamic finance, Gharar is observed within derivative transactions, such as forwards, futures and options, in short selling, and in speculation. Most derivative contracts are forbidden and considered invalid because of the uncertainty involved in the future delivery of the underlying asset. In Insurance, the prohibition of Gharar is used by different schools to argue that

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<sup>114</sup>Uddin A Principles of Islamic Finance: Prohibition of *Riba*, *Gharar* and *Maysir*

<sup>115</sup> Gharar (uncertainty) originates from the Arabic verb *gharra*, which means to deceive. The definition of *gharar* refers deceit, uncertainty, hazard and risk. <http://www.investopedia.com/terms/g/gharar.asp> (accessed 07 September 2013)

<sup>116</sup> Usa Ibp *Dubai Business Law handbook; Strategic Information and business law* (2005) at 37

<sup>117</sup> The counter value refers to something being deferred e.g. payment or delivery. For a payment to be deferred, it is allowable in Islam and accepted as a debt

<sup>118</sup> See, Professor Dr Engku Rabiah Adawiah “Applied *Shariah* in Financial Transactions” (2006) at 36. <https://ribh.files.wordpress.com/2007/10/applied-shariah-in-financial-transactions.pdf> (accessed 5 May 2015)

insurance is not valid in Islam.<sup>119</sup> The critics argue that insurance cannot be accepted in Islam because it is not certain.<sup>120</sup> The uncertainty stems from the payment of sum insured because the insured pays a monthly premium and has no knowledge that the payment under the policy will ever be received because such payment is payable only if the risk materialises. Also, when a payment is received the amount is uncertain and depends on the loss sustained.

The rule against Gharar also affects the damages which are awarded. Thus damages for loss of anticipated future profits, loss of business reputation and loss of goodwill are not ordinarily recoverable because claims of this nature are considered speculative. Liquidated damages agreements, on the other hand, are valid and enforceable under Islamic law because the rights and obligations of contracting parties are clearly defined.<sup>121</sup> However, in *Takaful*, Gharar is avoided by firstly by ensuring that the matter of insurance is a legitimate and essential need. Secondly, that the insurer is able to safeguard the interests of the insured and lastly that the insurance is transacted on a co-operative basis under which ownership of the premium is with all contributors to the *Takaful* fund; they collectively bear the risk and can share profits or losses from the pool.

#### **2.6.2.6 The prohibition of speculation (Maysir)**

The concept of speculation known as *Maysir*<sup>122</sup> refers to the easy acquisition of wealth by chance, irrespective of whether or not it deprives the other

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<sup>119</sup> *Shariah* compliant contracts

<http://www.nortonrosefulbright.com/knowledge/publications/34789/islamic-outsourcing> (accessed 18 May 2015)

<sup>120</sup> Ahmad W Some Issues of Gharar (uncertainty) in insurance

[https://www.isfin.net/sites/isfin.com/files/some\\_issue\\_of\\_gharar\\_in\\_insurance.pdf](https://www.isfin.net/sites/isfin.com/files/some_issue_of_gharar_in_insurance.pdf) (accessed 21 January 2019)

<sup>121</sup> Islamic contract law [http://www.saudilegal.com/saudilaw/02\\_law.html](http://www.saudilegal.com/saudilaw/02_law.html) (accessed 28 November 2014)

<sup>122</sup> Some examples of *Maysir* activities include horse racing, lottery, and crossword puzzles

person's rights. The Quran prohibits gambling (*Maysir*) in clear terms 'O you who believe! Alcoholic drinks and games of chance and idols and divining arrows are only an infamy of Satan's handiwork, leave it aside in order that you may succeed.'<sup>123</sup> *Shari'ah* law declares that *Maysir* is unacceptable because it can lead to immorality and social problems like poverty.<sup>124</sup> These are deemed against Islam because they have a speculative nature and are not certain. This also applies to modern financial instruments such as future and options,<sup>125</sup> which are not allowed in Islam for similar reasons.

Muslims are in agreement on the prohibition of *Maysir*, it is nevertheless a high-risk transaction which leads to financial and societal problems. Gambling wreaks havoc in a society because it does not add any value or growth to societal wealth.<sup>126</sup> The important inference of the prohibition of *Gharar* and *Maysir* is that conventional insurance cannot be permitted. Under conventional insurance, an amount of money, the insurance premium, is paid but it is not known beforehand what will be received in return. The return may be a large sum of money or nothing. The payment of a premium in return for a reduction in risk or uncertainty is not acceptable in Islam. One cannot sell what one does not yet possess, as future delivery would not be assured.<sup>127</sup> In the case of *Takaful*, however, collected premiums are in a common fund. If the participant draws out of it by way of benefit in the case of a claim, it is drawing out of a fund of which he is a member and to which he has contributed.

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<sup>123</sup> Quran 5:90

<sup>124</sup> Hayward K and Colman R "*The costs and benefits of gaming*" (2004) at 28

<sup>125</sup> Forwards are contracts for future delivery concluded directly between buyer and seller, futures are standardized contracts for future delivery traded on an exchange

<sup>126</sup> Gait, A and Worthington AC "A Primer on Islamic Finance: Definitions, Sources, Principles and Methods," *University of Wollongong, School of Accounting and Finance Working Paper Series No. 07/05* (2007)

<sup>127</sup> Visser H "Islamic finance: aims, claims and the realities of the market place" (2012) at 26

*Riba* is heavily applied in conventional insurance. *Riba* is practiced in two areas which are the paying and/or receiving interest. This is related to both, the investment (e.g.: investments in deposits or bonds) and liability (e.g.: interest on policy loans) sides, and is not permissible. There is a discrepancy between premiums paid and claims benefit received. There is also a discrepancy between the amount paid and the difference in timing (*Riba Al-Fadl and Riba Al-Nasiya*).

The commercial purpose of Islamic banking is the same as conventional banking but needs to operate within the principles stated above. Islamic financial products are often based on the principles of risk sharing and profit sharing. The key concepts used are profit sharing (*Mudaraba*), safekeeping (*Wadiah*), joint venture (*Musharaka*), cost plus (*Murabaha*) and leasing (*Ijara*). Such sharing principles can provide sustainable financial returns to investors by yielding a potential profit in proportion to the risk assumed. This class of structured products can satisfy the demands of investors in the modern environment within the recommendations of the Islamic law.

## **2.7 THE PRODUCTS, SERVICES AND CONTRACTS OF ISLAMIC FINANCE**

This paper will not delve into the different applications of Islamic law to financial transactions under each school of thought. Instead, it will focus on the most common financial structures currently in use. Islamic finance is still uncharted territory for most practitioners and policy-makers.<sup>128</sup>

The *Takaful* product was launched in South Africa in 2003.<sup>129</sup> *Takaful* is being used by several banks in South Africa to facilitate their customers who are interested to have the Islamic features of insurance. The banks

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<sup>128</sup>Goud B “The European Financial Review”

<http://www.europeanfinancialreview.com/?p=4941> (accessed 11 September 2017)

<sup>129</sup>Absa Africa Target for Islamic insurance <https://www.iol.co.za/business-report/companies/absa-africa-target-for-islamic-insurance-1379644> (accessed 17 October 2017)

include First National Bank and Absa Bank. Since present day trends indicate that Islamic banking will continue to increase its penetration policymakers and practitioners need to become acquainted with this process and its implications for financial supervision.<sup>130</sup> Practitioners need to understand these principles in order to be able to provide the services and products demanded by consumers that want to comply with Islamic principles. At the same time, supervisors need to know the challenges that these new financial products and institutions will impose on the regulated entities, as well as the potential implications of the interaction between Islamic and conventional banks.

In understanding Islamic finance including *Takaful* it is important to start with an overview of Islamic financial products, services and contracts because Islamic finance is the application of Islamic law to financial and commercial transactions. Islamic banking products, services and contracts are based on the principles of trade, partnership, sharing of gains and losses and the prohibition of reckless risk. In Islamic law, owners of capital are encouraged to invest their money and form a partnership whereby they share their profits and risks. *Shariah* does not permit interest over what is lent but allows for profits to be earned. Therefore Islamic banks cannot charge interest and their participation is based on a profit and loss sharing mode. The risk involved is reduced by careful investments policy, diversification of risks and prudent financial management.

The Islamic contracts lay the foundations for contemporary Islamic contracts to be used and developed in the Islamic finance industry. With the development of viable Islamic alternatives to conventional finance, the following *Shariah* compliant contracts are now available to Muslims for their financial needs:

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<sup>130</sup>“Comparative Discussion on Islamic banking and customary banking system”<http://www.lawyersjurists.com/article/23589/comparative-discussion-islamic-banking-customary-banking-system.html> (accessed 29 September 2017)

- a) *Mudaraba* based contract– sale contract
- b) *Musharaka* based contract – Partnership
- c) *Murabaha* – Mark up financing
- d) *Ijara* – rental/lease
- e) *Tawarruq* – overdraft facilities.
- f) *Istisna 'a*
- g) *Salam*
- h) *Ar-Rahnu*- Islamic pawn-broking.
- i) Islamic Securitization.
- j) Islamic hedging of currency Risk.
- k) *Qard Hasan*.

### **2.7.1 Mudaraba based contracts**

This is the traditional method of Islamic banking. The bank uses the client's money for investment purposes for example in real estate. The client receives a profit in terms of an agreed fixed rate. The loss is borne by the financier (bank) and the entrepreneur (borrower) loses his time and effort. The bank also carries losses in terms of the investment except in a case of negligence and there should be no intervention from the investor in the management of the business. The bank is the sole contributor of finances. In this type of contract, capital is given due recognition and it more equitable than conventional interest-based banking. Banks are more concerned with profits than the creditworthiness of the borrower. In conventional banking, the bank receives the repayment of capital and interest, even if there was no profit obtained. The loss is solely borne on by the debtor.<sup>131</sup>

### **2.7.2 Musharaka based contracts**

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<sup>131</sup> Alkheil A "Ethical banking and finance: A theoretical and empirical framework for the cross country and inter-bank analysis of efficiency, productivity, and financial performance (2012) at 15

This is a joint venture whereby the bank and the investor reach an agreement about the distribution of profits and losses. Profit is shared according to the pre-arranged agreement whilst losses are borne according to each party's equity share in the partnership. The investor has an option as to whether he wants to participate in the management of the investment. This encourages parties to put their best efforts to earn profits because they know the risks of incurring losses. Due to the risk, *musharaka* is used on a small scale by Islamic banks. In the western banking world the bank is not involved in profit and loss neither is the bank involved in a joint venture system of owning or selling goods.

### **2.7.3 Murabaha based contracts**

The term *Murabaha* comes from the Arabic word "*rabh*" which means profit (short-term trade financing). *Murabaha* is a type of sales contract (*bai'*) which, in its most basic form, consists of a bank or financial institution purchasing an asset (*mal*) and selling it back to the customer.<sup>132</sup> The customer in turn will make one or more deferred payments over time to cover the payment for the asset plus the mark-up, which is the profit element for the bank.<sup>133</sup> This is a popular type of transaction whereby the bank buys a product and resells the said product at an increased price to the client. The resale is at an agreed profit which includes financial costs. The client pays for the use of the finances in a way of profit and not interest. As an example, a client wishes to buy a container of goods and applies to the bank for finances. The bank buys the goods and resells it to the client for example at an extra 15% profit. The client agrees and repays the bank at a future date as agreed with the bank.

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<sup>132</sup> Mudaraba: A New Era

<http://www.nortonrosefulbright.com/files/us/images/publications/20110715MurabahaANewEra.pdf> (accessed 22 January 2019)

<sup>133</sup> Hart A and Childs A "*Murabaha: A New Era*" (2011) at 425 *Butterworth's Journal of International Banking and Financial Law*



Unlike a loan contract with a conventional bank, *Murabaha* is a contract of sale and is used to help the client. In a case of default by the purchaser, unlike a conventional bank, the only recourse an Islamic bank has is repossessing the property. The purchaser cannot be penalised and the amount outstanding cannot be increased over time, in the manner interest-based banks work.<sup>134</sup> This is an example of a sale being used as a means of financing a transaction instead of the ordinary use of interest in the western and other systems.<sup>135</sup>

#### **2.7.4 *Ijara and Istinaa and Qard Hasan based contracts***

In many respects *Ijara* resembles leasing. *Ijara* is an arrangement whereby the lessor leases building, equipment or any other facility to a client at an agreed rent. The bank purchases the assets and leases it to the client. *Istinaa* refers to a contract of sale, whereby a benefit is sold before it has come into existence, for example, a client requires finance in order to do improvements to his home. The price is fixed and agreed by parties. The bank may receive payment for *Istinaa* in instalments or a lump sum.<sup>136</sup> *Qard Hasan* is an interest-free loan to finance welfare projects and to fulfil short-term requirements. The borrower only needs to repay the principal amount borrowed and additional money can be paid as a token of goodwill.<sup>137</sup>

#### **2.7.5 *Salam and Ar Rahn* based contracts**

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<sup>134</sup> See, remarks by Ahmed I ‘What if the world has been following Islamic financial practices?’ (2011).<http://www.theguardian.com/commentisfree/belief/2011/jan/07/islam-fairer-finance-moral-risk> (accessed 18 May 2015)

<sup>135</sup> Ibid

<sup>136</sup> Salahuddin (2009) at 27-35

<sup>137</sup> Timur Kuran *Islam and Mammon* (2004) at 4-16

Salam is a contract of sale whereby goods are sold before they come into existence. The price of the goods is paid in advance.<sup>138</sup> *Ar Rahn* is an arrangement where a valuable asset is placed as collateral for a debt. The collateral may be disposed of in the event of default. This is available to people from the lower income group to obtain capital. The repayment period is not as strict as conventional pawning and in the event of default, the pawned item is sold and proceeds received above the pawned item are returned to the client.<sup>139</sup>

### **2.7.6 Islamic Securitization and Islamic hedging of currency Risk**

Islamic securitization is a financial tool for new capital markets. Liquid assets are converted into marketable securities and this adds value to corporations and investors. Securitization connects corporate finance and capital markets.<sup>140</sup> *Islamic hedging of currency risk.*

Risk management is very important in conventional banks and Islamic banks have followed suit. The Deutsche Bank<sup>141</sup> developed an Islamic FX option which was approved by the Gulf Finance House (GFH)<sup>142</sup> *Shariah* board. This

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<sup>138</sup> Ibid

<sup>139</sup> Zaman Z “Practical guide to Islamic Banking and Finance.” [https://www.academia.edu/9996900/Marifas\\_Practical\\_Guide\\_to\\_Islamic\\_Banking\\_and\\_Finance](https://www.academia.edu/9996900/Marifas_Practical_Guide_to_Islamic_Banking_and_Finance) (accessed 15 January 2015)

<sup>140</sup> Ibid.

<sup>141</sup>The Deutsche Bank has been a strong player in the Islamic Finance industry for over a decade. They have been committed to the development of the industry and are recognized as a world-class provider of Islamic financial solutions that caters to our Islamic clients' funding and risk management needs. Deutsche Bank now has one of the most innovative and efficient structuring teams comprised of specialized Islamic Finance experts with cross product backgrounds and responsibilities enabling clients to benefit from Deutsche Bank's world class expertise. Deutsche Bank's core Islamic Finance structuring team is based in Dubai (UAE) and Doha (Qatar) with resources in London (United Kingdom) and Kuala Lumpur (Malaysia). [https://www.db.com/mena/en/content/islamic\\_finance.htm](https://www.db.com/mena/en/content/islamic_finance.htm) (accessed 7 April 2014)

<sup>142</sup> The Gulf Financial House was established in 1999 and is considered to be one of the leading gulf banks that provides a unique investment approach to its investments with the key objectives of unlocking investment opportunities in the Islamic financial investments and

product helps eliminate foreign exchange risks and allows Islamic institutions to hedge their foreign currency investments in accordance with Islamic law principles.

## 2.8 Criticism of Islamic Banking

The challenges facing Islamic bank is the diversity amongst Islamic Scholars, due to which consumers and investors are uncertain about whether a particular product or practice is *Shariah* compliant.<sup>143</sup> The absence of a comprehensive set of regulatory framework on the *Shariah* governance may cause problems to the development of Islamic finance. This chapter examines and explores the different controversies in the minds of people which need to be addressed.

According to Kuran, Islamic banking is its own worst enemy.<sup>144</sup> By fostering trickery and duplicity, it hinders the task of imbuing businessmen with norms of truthfulness and trustworthiness.<sup>145</sup> It has been suggested by Kuran that Islamic economics stems from the 7<sup>th</sup> Century and has not developed since then.<sup>146</sup> The economy was prehistoric, produced very little commodities and used steadfast and uncomplicated technologies.<sup>147</sup> Islamic law was an answer to prehistoric dilemmas and not to new conditions and changes. Timur

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harnessing economic growth in some of the world's most dynamic emerging economies.  
<http://03b9b7f.netsolhost.com/corporate-profile/> (accessed 2 December 2014)

<sup>143</sup> [https://www.researchgate.net/publication/266915505\\_Islamic\\_banking\\_controversies\\_and\\_Challenges](https://www.researchgate.net/publication/266915505_Islamic_banking_controversies_and_Challenges) (accessed 22 January 2019)

<sup>144</sup> T Kuran Islamic Economics and the Islamic Subeconomy (1995) *The Journal of Economic Perspectives* Vol. 9, No. 4 at 155-173

<sup>145</sup> T Kuran Islam and Mammon "The Economic predicaments of Islamism" (2004) at 16

<sup>146</sup> T Kuran Islam and Mammon "The Economic predicaments of Islamism" (2004) at 16

<sup>147</sup> T Kuran Islam and Mammon "The Economic predicaments of Islamism" (2004) at 16

Kuran<sup>148</sup> adds that medieval times did not feature banks or organisations, this was brought about by the Europeans, thereafter Islamic law changed openly, to adapt to modern times and this is why it resembles contemporary banking.<sup>149</sup>

Islamic finance draws heavily from contemporary ideas and systems including from un-Islamic sources.<sup>150</sup> The modern day banks offer mortgages, car loans, credit cards, Islamic time deposit and guaranteed return accounts and Islamic insurance which resembles conventional banking products.<sup>151</sup>

Islamic economics claims, prehistoric solutions to contemporary issues and if no solution exists, it attempts to find justification in Islamic writs to support any alterations.<sup>152</sup> It has been also suggested, that Islamic law is not codified and throughout history, religious scholars issued legal rulings and opinions of matters governing all aspects of a Muslims life. Islamic law, is also, divided into two major schools of law; the *Sunni* and *Shia* which means that there is a difference in religious practices. The political and spiritual differences in the Islamic schools and the uncodified law inevitably results in conflict amongst scholars, in reference to the interpretation of Islamic rulings. This has even led to a concept known as “*fatwa* shopping”, whereby clients go to different *Shari’ah* advisory committees to find an Islamic interpretation that suits their needs.

Hussein Elasrag states that this leads to Islamic law being open to interpretation and inconsistencies.<sup>153</sup> There is always a possibility that the

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<sup>148</sup> T Kuran Islam and Mammon “The Economic predicaments of Islamism” (2004) at 16

<sup>149</sup> Ibid

<sup>150</sup> Ibid.

<sup>151</sup> See remarks, Foster J “How *Shariah* compliant is Islamic banking?” <http://news.bbc.co.uk/2/hi/business/8401421.stm> (accessed 1 May 2015)

<sup>152</sup> Ibid.

<sup>153</sup> Elasrag H “ *Principles of the Islamic finance :A focus on project finance*” (2011) at 15

interpretation on certain Shariah issues given by one sect of scholars is different from the other sects, which makes things complicated. The issue on the differences of various *fatwa* rulings amongst the *Shari'ah* boards may affect the Islamic finance image especially when international entities established their Islamic banks in different jurisdiction.

The fundamental rule in Islam is that interest is forbidden. To comply with this prohibition Islamic banks have disguised the term of interest as “profit.” Profit and loss sharing predates Islam and was practised by non-Muslims. Many Islamic banks have also failed to adopt profit loss sharing in their business. Bankers by default do not like profit and loss sharing, and hence it will always be difficult to build an Islamic banking model on the basis of profit and loss sharing.<sup>154</sup> Even if banker’s arms are twisted to adopt profit and loss sharing, the regulators in most countries are also averse to the concept.<sup>155</sup> Islamic contracts are actually based on thinly disguised interest and Islam banks use legal fictions to make transactions interest free<sup>156</sup>

Therefore, Islamic banks rest on the blindness to the falsity of profit and sharing and are not affected by the fact that they are financially connected to the conventional banking system which means that financial danger that will bring them tumbling down with the other banks.

## 2.7 Chapter Conclusion

Islamic banks enter into various commercial contracts (as given above). The nature of the underlying contract differentiates the additional revenue from being an interest or a profit. The nature of Islamic financial products is such,

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<sup>154</sup> Dar HA Lack of Profit Loss Sharing in Islamic Banking, Management And Control Imbalances *International Journal of Islamic Financial Services Vol. 2 No.2*

<sup>155</sup> Penalties are interest <http://www.freemalaysiatoday.com/category/business/2013/09/09/mudaraba-%E2%80%94-an-alternative-model-for-investment-banking-in-m%E2%80%99sia/> (accessed 28 January 2013)

<sup>156</sup> Ibid

that it is structured on the principles of trade, profit and loss or lease arrangements. This brings about a distinction between Islamic and conventional law. The distinctions which can easily differentiate Islamic banking products and conventional banking offerings include the prohibitions of interest, uncertainty and gambling. The establishment of a *Shariah* Committee is one of the most important difference between an Islamic banking business and conventional banks. It provides an oversight accountability in ensuring that all the operations of an Islamic Bank is consistent with the rules of *Shariah*.

Both South Africa's conventional insurance and Islamic insurance follow common law in the way they provide security against loss against person or property. The purpose of Islamic insurance is to achieve the same quantifiable objectives that are achieved by conventional insurance. The only difference is the way funds are shared between policy holders and the *Takaful* operator in a manner which eliminates interest and prohibits speculative contracts. The South African collective investment schemes which are fairly new in the market utilise Islamic financial products.

Islamic Jurists have conducted extensive studies on conventional insurance. Arising from these studies, the Islamic jurists confirm that the operation of conventional insurance does not conform to the principles of Islamic law. *Takaful* has been formulated as an alternative form of insurance. The next chapter presents an overview of Islamic Insurance (*Takaful*) objectives, elements and principles (*Takaful*). The principles of *Takaful* are described to provide a background and understanding to Islamic Insurance and to clear the differences between conventional insurance and Islamic Insurance.

Currently, there is no separate regulation in South Africa, dealing specifically with *Takaful*. This means that *Takaful* is regulated by the laws governing

conventional insurance.<sup>157</sup> In Malaysia, *Takaful* has developed as a component of comprehensive Islamic financial system operating in parallel with conventional financial system. The approach taken by Malaysia is to enact laws that are separate from conventional finance as the legal foundation for the conduct of Islamic finance. What follows in the next chapter is some of the fundamental principles that comprise the Malaysian *Takaful* system.

Regulators in South Africa have taken steps to promote Islamic law .South Africa has one of the most efficient, advanced financial, legal and tax frameworks as well as governance structures and regulations in the continent. This gives SA a competitive edge and a first mover advantage in promising an advancing *Takaful* in the country.

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<sup>157</sup> Bodiat A 'Takaful: An Introduction'

<http://nortonrosefulbright.com/knowledge/publications/64635/takaful-an-introduction>

(accessed 13 September 2017)

## CHAPTER THREE: PRINCIPLES OF ISLAMIC INSURANCE KNOWN AS *TAKAFUL*

### 3.1 INTRODUCTION

*Takaful* is an alternative model of conventional insurance and constitutes an integral part of the Islamic economic system. The emergence of Islamic insurance (*Takaful*) has been due to the demand of the Muslim communities. The Islamic Insurance (*Takaful*) industry in Africa is growing steadily, with *Takaful* operators offering a variety of products from basic motor *Takaful* products to complex pension schemes.<sup>158</sup> Conventional insurance is not considered to be *Shariah* compliant because it includes three key elements prohibited by Islamic law. The elements are uncertainty (*Gharar*), gambling (*Maysir*) and interest/usury (*Riba*) as discussed previously. Therefore, this chapter examines the fundamental principles of *Takaful* to determine how they can be accommodated in South African Law. An analysis of the difference between Islamic Insurance and conventional insurance as offered in South Africa is discussed below.

Further, an evaluation of the Malaysian *Takaful* system that is uniquely codified into both the conventional and Islamic system is vital in this part of the study. The suggestion in this part of the study is for South Africa to adopt a similar dual system as that in Malaysia. This would serve as an advantage for the South African legal system in dealing with changes that pose potential unexpected controversies.

### 3.2 Background of Islamic Insurance

Traditional attitudes prevail which hold the view that conventional insurance is not compatible with Islam. Due to the elements of “chance” in all insurance contracts, Islamic jurists have likened the insurance business to gambling,

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<sup>158</sup> *Takaful* same but different <https://home.kpmg.com/za/en/home/insights/2016/08/takaful-same-but-different.html> (accessed 9 September 2016)



which is prohibited in Islam.<sup>159</sup> The objection is not against conventional insurance but against the existence of uncertainty, usury and the speculative nature of conventional insurance contracts. Many Muslims still use the Western conventional contracts to manage their risks irrespective of their reservations regarding the morality of the practice. Islamic scholars could not prescribe any alternatives to assist the Muslims in complying with *Shariah* law.<sup>160</sup>

In addition, the duty to apply the sources of Islamic law falls upon the council of Islamic jurists in whom the legislative function of deriving laws from the book of God and the teachings of the Prophet are vested. Over decades, the commercial insurance contract has been a subject matter of extensive studies, discussions and debates amongst the Islamic jurists.

The Islamic ruling on the invalidity and unlawful nature of a conventional contract were implemented after many years of deliberation.<sup>161</sup> The first Islamic jurist to scrutinise an insurance contract was Ibi Abidin during the early 19<sup>th</sup> century. Ibi Abidin was the first Islamic scholar to develop the meaning, concept and legal basis of an Islamic insurance contract.<sup>162</sup>

The second Islamic jurist that examined an insurance contract was the Mufti of Egypt, Sheik Muhamad Bukit. Sheik Bukit re-affirmed the views of Ibi Abidin pertaining to the invalidity of the insurance contract.<sup>163</sup> On the 28 May 1901,

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<sup>159</sup> Julian Burling, Julian M. Burling, Kevin Lazarus Research Handbook on International Insurance Law and Regulation 530

<sup>160</sup> See Khan L "How does Takaful differ from insurance?" <http://www.kantakji.com/media/2919/n104.pdf> (accessed 25 May 2015)

<sup>161</sup> Fisher O and Taylor D "Prospects for evolution of *Takaful* in the 21<sup>st</sup> Century" <http://www.takaful.com.sa/m4sub3.asp> (accessed 18 November 2014)

<sup>162</sup> M Sagedi *The evolution of Islamic Insurance-Takaful: A Literature Survey. Insurance Markets and Companies* Insurance Markets and Companies: Analyses and Actuarial Computations, Volume 1, 2010 at 102

<sup>163</sup> M Sagedi *The evolution of Islamic Insurance-Takaful: A Literature Survey. Insurance Markets and Companies* Insurance Markets and Companies: Analyses and Actuarial Computations, Volume 1, 2010 at 102

Sheikh Mohammed Abdu validated a life insurance contract.<sup>164</sup> His viewpoint was that a life insurance contract is Islamic. The reason for his viewpoint is that the contract follows the principles of profit sharing (*Mudaraba*) and thus compliant with Islamic laws.<sup>165</sup>

The verification was made in accordance with the Islamic judicial opinions (*fatwa*). Furthermore, this was approved by the unanimous decision by Muslim scholars in a seminar held in Morocco on May 6, 1972. The judicial opinions issued in the national religious council of Malaysia in 1972 also favoured the decision. This decision was also upheld by the supreme court of Egypt on December 6 in 1926, the unanimous resolutions and judicial opinions by Islamic scholars (*ulama*) in the Muslim League conference in Cairo in 1965.<sup>166</sup>

In Islam, scholars and jurists have developed their own methodology for the classification of sources, derivation of specific rules from general principles. They continued to search for an alternative to conventional insurance. This led to the emergence and evolution of Islamic Insurance and the birth of the *Takaful* contract. This viable alternative to conventional insurance called *Takaful* was approved by the *fiqh* council of the organisation of Islamic conference (1985) in Jeddah, Kingdom of Saudi Arabia. In the Jeddah conference it was stated that conventional insurance is against Islam because it involves gambling, uncertainty, and interest charges and debt investment instruments. Lastly, it observed that insurance companies are guided by the principle of profit maximisation and not for the interests of the insured. At the conference it was further stated that *Takaful* accords with Islamic law and is

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<sup>164</sup> Saiti B and Abdulla A “*The Legal Maxims of Islamic Law (Excluding Five Leading Legal Maxims) and Their Applications in Islamic Finance*” *Islamic Economics*. (July 2016) at Volume 29, No. 2 at 139-151

<sup>165</sup> Tolefat AK and Asutay *Takaful Investment Portfolios: A Study of the Composition of Takaful Funds* (2013)

<sup>166</sup> Billah M “Sources of law affecting *Takaful*” Volume 2 No.4 *International Journal of Islamic Financial Services*

permissible. Many scholars have published their own treatises and *fatwa* on the subject in various capacities. All of these studies prohibit the involvement in the current version of the commercial insurance because it contains the elements of interest, uncertainty and speculation.<sup>167</sup>The majority viewpoint by Islamic scholars is that *Takaful* is permissible and consistent with the *Shari'ah* principles. This was upheld by the judicial opinions of councils that Islamic insurance is different from commercial insurance and therefore consistent with *Shari'ah*. In 1985, the grand council of Islamic scholars in Mecca called the *Majma al-fiqh* and approved the *Takaful* contract as the correct alternative to conventional insurance.

The *Takaful* contract is therefore in full compliance with the *Shari'ah* whilst conventional insurance is against Islam because of the elements of interest, uncertainty and gambling. The decision of the jurists was to formulate the *Takaful* program in agreement with the *Shari'ah* legal maxim 'All things originally are permissible unless there is evidence to prove their prohibition.' This maxim means that the existence of financial products and the benefits is fundamentally for the utilisation of man and therefore valid.<sup>168</sup>

### **3.2.1 Definition and Interpretation of *Takaful***

*Takaful* is grounded on observing rules and regulations of Islamic law dates back 1400 years. The primary source (*Hadith*) of Islamic law reveal Muslims practised cooperative risk sharing since then. This is verified in the following *Hadith*, narrated by Hazrat Anas Bin Malik. One day the Prophet noticed a Bedouin leaving his camel without tying it. The Prophet asked the Bedouin, 'Why don't you tie down your camel?' The Bedouin answered, 'I put my trust in Allah (God).' The Prophet then said, "Tie your camel first, and then put your trust

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<sup>167</sup> See, Muhamad Badri Bin Othman Development and *Shariah* issues of the *Takaful* industry in Malaysia: effects of the regulatory framework on the implementation and growth (2012) at 8

<sup>168</sup> Ahmed A, Osmani NM *Shariah* Maxim and their implications on Modern Financial Transaction Journal of Islamic Economics, Banking and Finance Volume 6 No 3

in Allah.”<sup>169</sup> The moral of the *Hadith* is that we must take responsibility and action first before a person expects the help of Allah to come through. This depicts as to how Muslims need to minimize risks and calamities that they will endure.

*Takaful* is a word describing *Shariah* compliant insurance and it originates from the Arabic verb *Kafala*, which means a guarantee.<sup>170</sup> *Takaful* has been defined as ‘a concept whereby a group of participants mutually guarantee each other against loss or damage. Each participant fulfils his/her obligation by contributing a certain amount of donation (or *Tabarru*) into a fund, which is managed by a third party called the *Takaful* operator.’<sup>171</sup>

This interpretation of *Takaful* entails “mutual assurance” or “joint responsibility” and includes the pooling of resources which is used to help those in need. A group of individuals with a common intention combine their money. In a case of a claim, the money contributed is paid over to the individual that suffered harm. *Takaful* insurance is therefore based on the premise that the risk is distributed amongst a group of people instead of the individual alone. The participants of the scheme all get a guarantee and support each other at a time of loss and this basis serves as a cooperation of mutual agreement. Under a *Takaful* policy, the nominee receives the amount of premiums paid, the share of profits and bonuses.<sup>172</sup> Conventional insurance only covers losses, whilst *Takaful* covers losses and profits. If there

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<sup>169</sup> Al Quran *Sunan at-Tirmidhi*

<sup>170</sup> An Introduction to *Takaful*  
<http://www.nortonrosefulbright.com/knowledge/publications/64635/takaful-an-introduction>  
(accessed 12 September 2013)

<sup>171</sup> Definition of *Takaful* as interpreted by Bank Negara Malaysia  
[http://www.bnm.gov.my/microsites/financial/0204\\_ib\\_Takaful.htm](http://www.bnm.gov.my/microsites/financial/0204_ib_Takaful.htm) (accessed 16 November 2014)

<sup>172</sup> Maysami RC and Kwon WJ “An Analysis of Islamic *Takaful* Insurance- A Cooperative Insurance Mechanism”  
[http://www.academia.edu/2178294/An\\_Analysis\\_of\\_Islamic\\_Takaful\\_Insurance\\_A\\_Cooperative\\_Insurance\\_Mechanism\\_Ramin\\_Cooper\\_Maysami](http://www.academia.edu/2178294/An_Analysis_of_Islamic_Takaful_Insurance_A_Cooperative_Insurance_Mechanism_Ramin_Cooper_Maysami) (accessed 7 May 2015)

are no losses, the insured receives all payments and profits back. This is supported by *Shariah*-compliant investments.<sup>173</sup>

### 3.2.2 The objectives and elements of a *Takaful* system

The main objective of a *Takaful* system is mutual help in the time of catastrophe. The policyholders agree to help one another by making a financial contribution. This contribution assists the policyholders at the time any defined loss has incurred. As a business venture, the *Takaful* company get fees, share in profits against their services and the policyholders also benefit by sharing in the profit. There is a concept of mutual protection practised in the Islamic era by establishing common pools amongst Muslim traders to jointly compensate the loss to any group member due to misfortune.<sup>174</sup> The principle of being virtuous in the relation with other human beings is the main feature of *Takaful* business and a *Takaful*-based policy.<sup>175</sup> There are essential elements that must exist to establish an efficient infrastructure for a *Takaful* regime.<sup>176</sup> These elements include a mutual guarantee, ownership of the fund, elimination of uncertainty, management of the *Takaful* fund and the investment conditions.<sup>177</sup> In terms of mutual guarantee, the basic objective of *Takaful* is to pay a defined loss from a defined fund. Losses and liability are shared between the insurer and the insured and are covered by the

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<sup>173</sup> Mazair S “*Conventional Insurance and Takaful: conceptual and operational difference*” (2013) at 273-276

<sup>174</sup> Ridhwan A *Takaful and Conventional Insurance: A Comparative Study* international journal of management sciences Volume 2 No 12 2014

<sup>175</sup> Dr Yasid “Socio benefits of *Takaful*” <http://www.kantakji.com/insurance/socio-benefits-of-takaful-islamic-insurance.aspx> (accessed 25 September 2014).

<sup>176</sup> The World *Takaful* Report 2012. Issued by Ernst & Young. <http://uaelaws.files.wordpress.com/2012/04/the-world-takaful-report-2012.pdf> (accessed 25 September 2013)

<sup>177</sup> Ridhwan A *Takaful and Conventional Insurance: A Comparative Study* international journal of management sciences Volume 2 No 12 2014

contributions of the policy holders.<sup>178</sup> The ownership of a fund vests in the policyholders who by their contributions are entitled to profits. Different conditions are applicable to the type of policy chosen.<sup>179</sup> Uncertainty is eliminated because contributions are made voluntarily, with the intention of helping policyholders and not for any monetary benefit.<sup>180</sup> The *Takaful* fund is managed by an operator in accordance to the type of contract taken by the policy holder for example either according to *Mudaraba* or *Wakala* contract.<sup>181</sup> Investments must be made according to *Shari'ah* law; therefore, investments in industries such as clubs, casinos, breweries etc. are taboo.<sup>182</sup>

### 3.2.3 The Principles of *Takaful*

A *Takaful* contract is an insurance contract based on Islamic models of financing concepts, where the participants pay contributions to a *Takaful* company. The principle underlying the contract of *Takaful* is that it is a voluntary donation to facilitate mutual assistance. The premiums (contributions) paid by the participants are credited into the pooling fund, which are then invested. The profits generated are paid back to the participants, who are entitled to a share of surplus and bear the risk of loss.<sup>183</sup>

The basic principles and functions of *Takaful* are summarized as follows:

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<sup>178</sup> Durshlag A, Reuters T Islamic Finance Instruments and Marketing at 18

<sup>179</sup> Archer S Abdel RA Takaful Islamic Insurance Concepts and Regulatory Issues at 22

<sup>180</sup> Ibid.

<sup>181</sup> Kettel B Case Studies in Islamic Banking and finance at 36

<sup>182</sup> Kettel B Case Studies in Islamic Banking and finance at 80

<sup>183</sup> Pakistan and Gulf Economist Dean Management Sciences, Institute of Business & Technology Volume No 34-37 2008 at 64

1. The responsibility of Islamic banks is in accordance with the principles of Islamic law.<sup>184</sup>
2. *Takaful* encourages risk sharing between investor and the trader.<sup>185</sup>
3. The objectives of *Takaful* are to maximize profit in accordance to Islamic law.<sup>186</sup>
4. The underlying purpose of an Islamic bank is to conform to the principle of partnership.<sup>187</sup>
5. Defaulters are liable for a small penalty which is distributed as charity.<sup>188</sup>
6. The development of appraisal and evaluations are significant for an Islamic bank.<sup>189</sup>
7. The viability of the projects is an important factor that is considered by Islamic banks.<sup>190</sup>
8. Profit is to be distributed according to the agreement of partnership.<sup>191</sup>
9. If the account is based on the participation concept, client has to share in loss.<sup>192</sup>
10. Funds are not invested in any “*Haram*” business activities.

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<sup>184</sup> Mufti Z Bayat “Islamic Information Centre, Durban Training Material for Old Mutual.” [https://www.oldmutual.com/download/16053/2011%20Old%20Mutual%20Foundation%20\(PDF\).pdf](https://www.oldmutual.com/download/16053/2011%20Old%20Mutual%20Foundation%20(PDF).pdf) (accessed 21 November 2014)

<sup>185</sup> Ibid

<sup>186</sup> Ibid

<sup>187</sup> See Hassan (2013) at 46

<sup>188</sup> Ibid

<sup>189</sup> Ibid

<sup>190</sup> Ibid

<sup>191</sup> Ibid

<sup>192</sup> Ibid

### 3.2.4 The Concept and Operation of a *Takaful* company

Islamic banking and financial companies, like any other conventional institution, is a business organization where profit maximization is its main objective. Conventional insurance comprises an undertaking by an insurer in exchange for consideration to make a payment to either the insured or another if a specified event occurs. *Takaful* is based on the notion of social solidarity, cooperation and joint indemnification of losses of the members.

A *Takaful* company operates by an agreement. For example, in a *Takaful* company, the participants, mutually help each other by contributing financially on the basis of a donation. This agreement amongst a group of people also reciprocally guarantee each other against loss which may befall them.<sup>193</sup> There is no forfeiture of “premiums” if the policy lapses or the policy is surrendered. All premiums belong to the policyholder and the company, only manages the funds. The company invests funds according to *Shari’ah* requirements. The provision of the Islamic insurance cover conforms to *Shari’ah* on principles of profit sharing.<sup>194</sup>

### 3.2.5 The Difference between Conventional Insurance and *Takaful*

South Africa’s conventional insurance and Islamic insurance follow common law, in that both systems provide security against loss against person or property. The purpose of Islamic insurance is to achieve the same quantifiable objectives that are achievable by conventional insurance. The distinction between conventional insurance and *Takaful*, is that in *Takaful*, funds are shared between policy holders in a manner which eliminate interest and prohibit speculative contracts.

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<sup>193</sup> Overview of *Takaful* <http://www.takaful-malaysia.com.my/corporate/takafuloverview/pages/mudharabah.aspx> (accessed 25 May 2015)

<sup>194</sup> Ibid



The conceptual difference between *Takaful* and conventional insurance is that risk in *Takaful* is not exchanged by way of contribution payments. The combined premiums are used to protect participants from risk. In conventional insurance the contract is based on the principles of exchange of interest. The relationship is designed in such a way that the insured buys protection by payment of premium and an insurer provides security against the risk.<sup>195</sup>

Another distinction between *Takaful* and conventional insurance is that *Shariah* compliant companies can only invest in *Shariah* products which are free from gambling, interest and uncertainty. Conventional insurance permits investments in any legal instrument. The purpose of a conventional insurance contract is to transfer to the insurer a patrimonial or non-patrimonial risk burdening the insured. There is no religious reason for taking out a policy. The only social function of conventional insurance is to sell safety. *Takaful* differs from conventional insurance in the sense that the company is not the insurer insuring the participants. The persons participating in the scheme mutually insure one another and this is the very essence of the rationale behind the concept of *Takaful*.

### 3.3 The Regulatory Framework Governing Takaful

Since the development and progress of Islamic finance, organizations have been established to provide guidance to the industry.<sup>196</sup> Adam Smith<sup>197</sup> explains that though the principles of the banking trade may appear somewhat abstruse, the practice is capable of being reduced to strict rules.<sup>198</sup> He further adds ‘that to depart on any occasion from these rules, in consequence of

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<sup>195</sup>Deposit Insurance from the Shariah Perspective  
[https://www.iadi.org/en/assets/File/Papers/Approved%20Research%20-%20Discussion%20Papers/DP-DI\\_From\\_Shariah\\_Perspective\\_\(Final\)\\_Sep2011\\_to\\_IADI.pdf](https://www.iadi.org/en/assets/File/Papers/Approved%20Research%20-%20Discussion%20Papers/DP-DI_From_Shariah_Perspective_(Final)_Sep2011_to_IADI.pdf)  
(accessed 24 January 2019)

<sup>196</sup> Gait AH A Primer on Islamic finances: Definitions, Sources, Principals and Methods 2007

<sup>197</sup> Smith A “*The Wealth of Nations*” (1776) at 810

<sup>198</sup> Ibid

some unflattering speculation of extraordinary gain, is almost extremely dangerous and frequently fatal to the banking company which attempts it.<sup>199</sup>

The financial crisis which was experienced by the International financial system has led to the emergence of a worldwide emphasis on prudential regulation, supervision and governance. The impact of the economic crisis affected *Takaful* on a very small basis. This created an opportunity for *Takaful* to continue and develop.<sup>200</sup> According to Ernst and Young,<sup>201</sup> the global growth of *Takaful* market is estimated to be over US\$20 billion by the year 2017.<sup>202</sup> Ernest and Young adds that the separate series of manoeuvres and regulatory compliance attempts have an adverse effect on the short-term financial development of operators in some markets.<sup>203</sup> It is therefore fundamental to establish regulations and guidelines to ensure that the financial legal system functions efficiently.

Due to the development of the *Takaful* industry, regulations and guidelines have been introduced in order for Islamic banks to function effectively. This is complemented with robust corporate governance which is important for successful operations of any organisation be it for conventional insurance or *Takaful*. The most recent reform that was implemented in regulation and supervision is the Basel 111 regime.<sup>204</sup> In the field of *Takaful*, corporate

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<sup>199</sup> Ibid

<sup>200</sup> Ibid

<sup>201</sup>The European financial Review  
[http://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=2ahUKEwi7j\\_6svYjgAhUN6OAKHd4iBB8QFjACegQIABAB&url=http%3A%2F%2Fwww.europeanfinancialreview.com%2F%3Fp%3D2822&usg=AOvVaw3WiQ4Og4-6\\_iz3JoVEeQNK](http://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=2ahUKEwi7j_6svYjgAhUN6OAKHd4iBB8QFjACegQIABAB&url=http%3A%2F%2Fwww.europeanfinancialreview.com%2F%3Fp%3D2822&usg=AOvVaw3WiQ4Og4-6_iz3JoVEeQNK) (accessed 25 January 2019)

<sup>202</sup> EY analysis International Monetary Fund, World Economic Outlook Database (2014) at 3 Ernst & Young Global *Takaful* insights.

<sup>203</sup> Ibid

<sup>204</sup>Basel 111 International regulatory framework for banks Basel III is an internationally agreed set of measures developed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007-09. The measures aim to strengthen the regulation, supervision

governance ensures the stability of the Islamic insurance sector and includes the protection of the rights of policyholders and internal and external shareholders. A few of the most essential legal and institutional mechanisms for effective corporate governance are related to the duties of the board of directors and management, Internal controls, effective risk management, adequate transparency, and mandatory compliance with accounting and auditing standards also play a roll. Corporate governance, supervision and monitoring the operations and performance of the Islamic banks are crucial in ensuring that banks carry the role to serve their client the Islamic way and without proper regulations, policies and enforcement, the consumer will have to bear great risks.<sup>205</sup>

### **3.4 A Description of the Malaysian *Takaful* System**

There are several *Shariah* insurance companies operating internationally, for example, Malaysia, Sudan and Saudi Arabia. Malaysia has a dual banking system which means that conventional insurance and Islamic insurance operate side by side. The advantage of this dual system is the opportunity of Muslims and non-Muslims to enjoy the flexibility of selecting the benefits from both of the banking systems. Currently, there are seventeen local and foreign banks registered and operating under Islamic law in Malaysia. These include the Bank Islam Malaysia Berhad, Bank Muamalat Malaysia Berhad, Maybank Islamic Berhad, Am Islamic Bank Berhad, CIMB Islamic Bank Berhad, HSBC Amanah Malaysia Berhad, Standard Chartered Saadiq Berhad, and Al-Rajhi Banking & Investment.<sup>206</sup>

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and risk management of banks.<https://www.bis.org/bcbs/basel3.htm> (accessed 25 January 2019)

<sup>205</sup>See, Islamic financial services Stability report 2013 <http://www.ifsb.org/docs/IFSB%20-%20IFSI%20Stability%20Report%202013%20%28Final%29.pdf> (accessed 20 May 2015)

<sup>206</sup> Marimuthu M Islamic Banking Selection Criteria and Implications (2010) Volume 5 Issue 4

The Malaysian *Takaful* industry which originated in the year 1982, is one of the most mature and vibrant insurance industry worldwide.<sup>207</sup> During the years, this industry has grown and developed a regulatory landscape with legislation comprising of the *Takaful* operator framework and the latest development which became operative was the Islamic Financial Service Act 2013. This Act repealed the Islamic Banking Act 1983 and the *Takaful* Act 1984. The purpose of the Financial Service Act is to set out the regulatory framework for the Malaysian Islamic sector and equip the Malaysian banks with adequate regulatory and supervisory powers. The regulatory objective is to promote financial stability, which is pursued by fostering the safety and soundness of financial institutions. Furthermore, the promoting of the integrity and orderly functioning of the money and foreign exchange markets, safe, efficient and reliable payment systems and payment instruments, fair and responsible and professional business conduct of financial institutions, and to strive to protect the rights and interests of consumers of financial services and products are the other objectives.<sup>208</sup>

The Central Bank of Malaysia (Bank Negara Malaysia) and the Security Commission (SC) regulate all registered financial institutions in Malaysia. Both regulators play crucial roles in the development of compliance, governance and also ensure all laws are adhered to. The main objectives<sup>209</sup> of the Malaysian Bank Negara include the establishment and promoting a sound and credible *Takaful* sector that conforms to *Shariah*. This also includes the ensuring of prudent management of the *Takaful* fund with high standards of corporate governance. The safeguarding of participants and stakeholders

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<sup>207</sup> Sharifuddin SS, Kasmoen N, Taha N, Talaat N, Aida Z and Talaat A “ The Concept of *Takaful* (Islamic Insurance) and its functions in the establishment of Syarikat *Takaful* Malaysia, the First *Takaful* Operator in Malaysia” (2016) Volume 5 Issue 12 at 43-48 *International Journal of Humanities and Social Science Invention*

<sup>208</sup> Section 61 to 66 of the Central Bank Act of Malaysia 2009

<sup>209</sup> Kamarulzaman D “Lessons learnt from *Takaful* operators in the Middle East and Malaysia” [www.takaful.coop/images/stories/Takaful & Mutuality Digital.pdf](http://www.takaful.coop/images/stories/Takaful & Mutuality Digital.pdf) · PDF file (accessed 10 December 2014)

interests, facilitating the intermediation role of the financial system in the national economy and the maintaining of public confidence in *Takaful* operators who are viewed as custodians of public funds are considered.

The Central Banks have placed great importance on “financial inclusion, enhanced accessibility to assist all groups and have also launched delivery channels in order to establish a resilient financial system.”<sup>210</sup> They have engaged in a united manner, to make certain, that the community including the indigent and vulnerable members can get involved in the formal financial system.<sup>211</sup> An attempt has been made to also promote consumer protection and to educate the consumers which will enable them to make informed decisions on financial products.<sup>212</sup>

A well established and integrated regulatory framework is pivotal and essential for the sustainable development of a competitive Islamic economy. A clearly defined and enforced legal and administrative framework determines how individuals, firms and governments interact. An articulate development and enforcement of a uniform Islamic financial regime are required to standardise and regulate the industry.<sup>213</sup>

Malaysia has adopted a very effective legal framework that covers regulatory and *Shariah* aspects as well as measures to the viability of the Islamic financial industry. In this regard, Malaysia has enacted regulatory laws that are, at least for banking and *Takaful* (Islamic insurance) industry, distinct from conventional finance as the legal framework for the management of Islamic

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<sup>210</sup> See, speech by Dr Aziz Annual Meeting and Finance Summit "Reflections on financial reform "Malaysia's experience, Beijing, 8 December <http://www.bis.org/review/r131211e.htm> (accessed 10 December 2014)

<sup>211</sup> Ibid

<sup>212</sup> Ibid

<sup>213</sup> See, remarks by Mufti Ismail Ebrahim Desai "Islamic Finance in South Africa: Key challenges and innovative solutions" (accessed 23 May 2014)

finance trades. This approach has proven to be successful and critical for clients to establish faith in the *Shariah* integrity of the industry. Whilst enacting a separate governing law steers clear of the ploy of restricting the sphere and performance of Islamic finance within the framework of conventional finance. This approach has proven in Malaysia to be a well organised way to regulate Islamic finance. The Malaysian system can offer not only protection for South Africa, but business opportunities for companies to create a solid platform for future development and growth.<sup>214</sup>

### 3.5 Conclusion

*Takaful* and conventional insurance policies work on the same basic system, which is the pooling of funds to manage the risk of a group of people. Having said that, there are major differences in the workings of the two systems, stemming from the fact that *Takaful* adheres strictly to the Islamic principles it was developed upon.

The strong growth of Islamic capital markets internationally has seen the corresponding development of regulatory frameworks incorporating *Shariah* law. Malaysia has been at the forefront of Islamic capital market regulatory development, merging corporate law drawn from its common-law heritage with *Shariah* principles.<sup>215</sup>

The next chapter presents the historical background of Insurance in South Africa and analyses the development of the Insurance law system. In addition, the chapter analyses the role of insurable interest in terms of English law, Dutch law, Roman Dutch law as well as South African law.

The South African collective investment schemes which are fairly new in the market utilise Islamic financial products. These financial products include

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<sup>214</sup> Marimuthu M Islamic Banking Selection Criteria and Implications (2010) Volume 5 Issue 4

<sup>215</sup> Marimuthu M Islamic Banking Selection Criteria and Implications (2010) Volume 5 Issue 4

*Mudaraba, Murabaha, and diminishing Musharaka.* Diminishing *Musharaka, Mudaraba, and Murabaha* became the operative transactional instruments for Islamic financial institutions in South Africa. For example, Absa Bank offers various financial products including Islamic Value Bundle, Islamic Cheque Account, Islamic Vehicle and Asset Finance, *Takaful* Motor and Household and Business Insurance, Islamic International Banking, Islamic Savings Islamic Term Deposit, and Islamic Youth Account. The next chapter offers a descriptive analogy of the conventional products offered in South Africa.

## CHAPTER FOUR: DEFINITIONS AND KEY ASPECTS OF THE SOUTH AFRICAN LAW OF INSURANCE AND FINANCE

### 4.1 INTRODUCTION

The Islamic legal regime is not catered for by South African law. The available framework which may be applicable to this type of insurance is presumed to be the same law which applied on conventional insurance. This means that the precepts of the Long-term Insurance Act 52 of 1998, the Short-term Insurance Act 58 of 1998, the Banks Act 94 of 1990, the Mutual Banks Act 124 of 1990, South African Reserve Bank Act 90 of 1989, and the Co-operative Banks Act 40 of 2007 are the guiding principles of *Takaful*. The next chapter analyses the legal framework governing South African law and includes a descriptive analysis of the above mentioned pieces of legislation.

The country's legal system is based on Roman-Dutch law, influenced by English law, and is subject to the *Constitution*, as the supreme law. South African insurance law has its roots in Europe's commercial law and due to its history, both Roman-Dutch and English law are considered to be the primary common law sources of South African Insurance law.<sup>216</sup> Various Acts of Parliament apply specifically to the insurance industry. The most important of these is the Long-term Insurance Act, No. 52 of 1998 (LTI Act), and the Short-term Insurance Act, No. 53 of 1998 (STI Act). The description of the Acts as well as the products will be discussed in this chapter.

This chapter presents the historical background of the South African legal system. This chapter elaborates on the historical reasons behind insurance law in South Africa. Insurance as we know it has had an interesting development in South Africa and many legal systems influenced the insurance contract as we know it.<sup>217</sup> Therefore the influence of English Law,

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<sup>216</sup> Davies E Foundations of Law

<https://www.ru.ac.za/media/rhodesuniversity/content/law/documents/courseoutlines2016/Foundations%20of%20Law%20Course%20Outline%202016.pdf> (accessed 24 January 2019)

<sup>217</sup> The History of South African Law <https://showme.co.za/facts-about-south-africa/history-of-south-africa/the-history-of-south-africa> (accessed 24 January 2019)



Roman Dutch law and Dutch law on the South African regime are also discussed. This chapter examines how South African Insurance law stems from wagers and bets which are in contravention to Islamic law principles. The chapter commences with an examination of the origins of the concept of insurable interest, and noted that its genesis is not in common law but rather in English statute, commencing with the Marine Insurance Act of 1745 and in subsequent English legislation pertaining to insurance and gaming. The commonly understood requirement that an insured must have an insurable interest in the subject matter of the insurance for a contract of insurance to be valid was recently placed under the judicial spotlight in the matter of Lorcom Thirteen (Pty) Ltd v Zurich Insurance Company of South Africa Limited.<sup>218</sup> The judgment raises some pertinent issues for underwriters.<sup>219</sup> The reason for the discussion of case law in this chapter is to prove that a contract of Insurance is a form of betting, wagers or gambling therefore against Islamic law principles.

The role of insurance in the South African context and the manner in which insurance contracts come into existence will be discussed. Furthermore the long-term insurance and short-term insurance detailed principles pertaining to each will be explained. We will examine English law, Roman Dutch law, and South African law on Insurable law in this chapter.

In addition, it is incomprehensible that any attorney or compliance officer who practices commercial law should not have a reasonable knowledge of insurance law. Recent developments such as the introduction of the Financial Advisory and Intermediary Services Act 37 of 2002, The Financial Intelligence Centre Act, Protection of the Constitutional Democracy against Terrorism and Related Activities Act 33 of 2004 created an intricate framework for Insurance and this has led to rigidity in the industry. In order to identify the challenges

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<sup>218</sup> 2013 (5) SA 42 (WCC)

<sup>219</sup> Bowley A 'Insurable interest, the indemnity principle and an unenforceable gamble' <http://www.polity.org.za/article/insurable-interest-the-indemnity-principle-and-an-unenforceable-gamble-2013-11-07> (accessed 19 September 2017)

faced by consumers, it is important to consider, compliance governance and risk management in South Africa. This will be examined in this chapter.

## **4.2 Historical Background of the Insurance Legal System in South Africa**

### **4.2.1 Background of Insurance law in South Africa**

Insurance law was introduced in the year 1652AD when Roman-Dutch law was brought to the Cape by Jan Van Riebeeck and his team. During the period of 1652AD and 1795AD, the most important sources of law were Statutes, Dutch law and customary law. South African courts also made references to the writings of jurists in Dutch provinces and other countries such as France, Germany, Italy and Spain, all of whom were linked to one another by the “*ius commune*.”<sup>220</sup>

After the arrival of the British settlers in 1820 AD, substantial changes were made to the law and legal systems. In 1879 AD, far-reaching changes were introduced by the General Law Amendment Act.<sup>221</sup> The effect of this Act was the introduction of the English maritime and shipping law as well as the English law relating to fire, life, marine insurance and bills of lading. Section 2 of the General Law Amendment Act 8 of 1879 reads as follows: ‘In every suit, action, and cause having reference to questions of fire, life, and marine insurance, stoppage in transitu, and bills of lading, which shall henceforth be brought in the Supreme Court, or in any other competent court of this Colony, the law administered by the High Court of Justice of England for the time being, so far as the same shall not be repugnant to, or in conflict with, any Ordinance, Act of Parliament, or other statute having the force of law in the Colony, shall be the law to be administered by the said Supreme Court or other competent courts.’ Section 3 of the same Act,

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<sup>220</sup> This diverse cultural history is reflected in the South African legal system, which is a hybrid of the indigenous African customary law, the European *ius commune* (which is Latin for common law), and the English common law. It is a civilian system and a common law system which was influenced by British rule and judicial practice

<sup>221</sup> Act 8 of 1879

provided that 'statutory enactments of the British parliament after the taking effect of the Amendment Act would not apply unless re-enacted in South Africa.'<sup>222</sup>

In 1977, the Old Cape and Orange Free State statutes were repealed by the Pre-Union Statute Law Revision Act.<sup>223</sup> The court in *Mutual and Federal Insurance Co V Oudtshoorn Municipality*<sup>224</sup> confirmed that South African law of insurance is governed mainly by Roman-Dutch law as our common law.<sup>225</sup> Insurance was therefore accepted in principle. The judge increased the parameters of authorities further than the Roman-Dutch writers. There is evidence that South African courts accepted the *ius-commune* and English law as an important part of our law. English law, in theory, was applicable to insurance contracts preceding the Act but it had an only persuasive influence on contracts after the Act came into force.<sup>226</sup>

Insurance contracts and wagering contracts are aleatory.<sup>227</sup> This means that insurance contracts depend on chance. In a wager, the risk of loss is created by the making of the bet itself. In contracts of insurance, insurance is to indemnify the insured in respect of the risk of loss to an interests he already possesses. Wagers expressed in the form of insurance policies were often interpreted as contracts of indemnity which mean if the insured was unable to

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<sup>222</sup> Ibid

<sup>223</sup> Act 43 of 1977

<sup>224</sup> 1985 1 SA 419 A

<sup>225</sup> Ibid

<sup>226</sup> Reinecke, Van Der Merwe, Van Niekerk and Havenga "*The General Principles of Insurance Law*" (2002) at 13

<sup>227</sup> Van Niekerk JP " The Development of the Principles of Insurance law in the Netherlands from 1500 to 1800 (1999) at 92

establish an insurable interest he could not recover.<sup>228</sup> The policy against wagering, the policy against rewarding and thereby tempting the destruction of property and the policy confining insurance contracts as indemnity are policies which are highlighted as a prerequisite for insurable insurance.<sup>229</sup> The development of the wagering policy behind the smokescreen of insurance began in England in terms of the Gaming Act 1845.

### **4.3 The concept of Insurable Interest**

Insurable interest means where the assured is so situated that the happening of the event on which the insurance money is to become payable would, as the proximate cause, involve the assured in the loss of a right recognised by law or in any legal liability there is an insurable interest in the happening of that event to the extent of the possible loss or liability.<sup>230</sup>

#### **4.3.1 English law on insurable interest**

In England, the eighteenth century marked the beginning of the illusion of insurance. Wagers were very popular in that century. Insurance was affected by factors such as war, return of a vessel from its destination, regardless of whether the person effecting the insurance had a pre-existing interest in the subject matter. These factors led to the enactment of the Marine Insurance Act 1745 and the Life Assurance Act 1774. This required a person taking out a policy to have an insurable interest in the subject matter of the insurance. The Marine Insurance Act 1909, stipulated in section 10 that “every contract for marine insurance by way of gambling or wagering was void.” All insurance

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<sup>228</sup> Bowley A “Insurable interest, the indemnity principle and an unenforceable gamble” <http://www.polity.org.za/article/insurable-interest-the-indemnity-principle-and-an-unenforceable-gamble-2013-11-07> (accessed 29 September 2017)

<sup>229</sup> Bertram Harnett and John V Thornton in *‘Insurable Interest in Property: A Socio-Economic Re-evaluation of a Legal Concept’* (1948) Volume 48, No. 8 at 1162-1188

<sup>230</sup> Botes EJ “Insurable interest as a requirement for insurance contracts: A comparative analysis” (LLM thesis North West University 2004). [https://dspace.nwu.ac.za/bitstream/handle/10394/19874/Botes\\_EJ\\_2015.pdf?sequence=1&isAllowed=y](https://dspace.nwu.ac.za/bitstream/handle/10394/19874/Botes_EJ_2015.pdf?sequence=1&isAllowed=y) (accessed 29 September 2017)

contracts except life, sickness and personal accident are contracts on indemnity. The insurer had an obligation to reimburse the insured for the actual loss suffered and such insured must be restored to the financial position he enjoyed immediately before the loss. If there was no interest at the time of the loss, the insured cannot suffer a loss and therefore cannot obtain indemnity.<sup>231</sup>

#### 4.3.2 Dutch law on insurable interest

The 1435 Ordinance of Barcelona required the insured to declare under oath that he or his principal was the owner of the insured goods.<sup>232</sup> Insurable interest is part of the estate or assets of the insured which, if it is adversely affected, results in loss or damage to the insured. In the Netherlands insurable interest forms, the foundation of indemnity insurance and the principle of indemnity is firmly based in Dutch law.<sup>233</sup> Pedro De Santarem<sup>234</sup> wrote the first book on Insurance in 1488, on Insurance and merchants bets.<sup>235</sup> In the book he outlined what may be the first modern definition of an insurance policy. The definition outlined refers a contract taken out in good faith, whose purpose is not to make the insurer rich but solely to avert losses. Insurance was seen as an agreement whereby one person, having agreed with another on the price of risk, takes upon himself others misfortune.<sup>236</sup> The question as to whether insurance policies were contracts of usury or not were argued by Pedro de Santarem. He argued that insurance was no other

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<sup>231</sup> Theo de Jager "The roots and future of the South African law of marine insurance" (1993) at 111.

<sup>232</sup> Ibid.

<sup>233</sup> De Jagter T *The roots and future of the South African law of insurance* (1993) at 103

<sup>234</sup> Magone GJ *United States Admiralty law* 1997 at 241

<sup>235</sup> See remarks of Nick Szabo the Birth of Insurance <http://szabo.best.vwh.net/insurance.html> accessed 21 May 2015)

<sup>236</sup> Ibid

than a sale of risk. He distinguished between proper and improper insurance. Proper insurance means that there is a real interest and this corresponds to real risks. Improper insurance corresponds to mere bets. The interest is created artificially and the interest in the bet and bets were considered unlawful.<sup>237</sup>

#### **4.3.3 Roman-Dutch law on insurable interest**

During the period of development of Roman-Dutch law, the contract on insurance was a contract between merchants. Therefore, parties to a policy were individuals. Insurance was compared to wagers on the safe arrival of ships and cargoes.<sup>238</sup> The early seventeenth century marked the emergence of insurance companies. Individuals who acted as insurers did so for speculative purposes only. There was no reputation or investment to protect therefore insurers were notorious for raising technical defences against claims. Writers such as Van Bynkershoek and Van Keesel produced the most extensive work on Roman-Dutch insurance law. The Roman-Dutch authorities such as Van den Linden, Van der Keesel, Van Bynkershoek did not advocate a doctrine of insurable interest such as that of English law. They focused on indemnity. Indemnity is whether the insured had suffered damage and was thus entitled to claim, not whether there was a valid policy. A contract of indemnity cannot be used as an instrument of gambling because an insured who does not suffer a loss covered by the policy has no claim. As far as the Roman-Dutch law is concerned, the insured must have a relationship to the matter insured beyond the existence of a policy. If the policy is the only source of such a relationship, one deals with a bet which is unenforceable. At the time of a claim under the policy, the question is different: one asks whether the insured has proved his claim and based on the facts there is a valid basis

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<sup>237</sup> Ibid.

<sup>238</sup> Holdsworth WS The early history of the contract of insurance (1917) Volume 17 No.2

for the claim.<sup>239</sup> The question, thereafter, is whether a risk has materialised and if so, what indemnity does the policy entitle the insured to recover?<sup>240</sup>

#### 4.3.4 South African law on insurable interest

The English law application of Insurance, for a time, was obligatory in South Africa.<sup>241</sup> In 1977, this obligation was repealed by section 1 of the Pre-Union Statute Revision Act 43 of 1977<sup>242</sup> with the result that the English law (as it existed in 1879) concerning fire, life and marine insurance is no longer binding authority in the Cape Province or in the Orange Free State Province.<sup>243</sup> Hence, the South African law of insurance is governed mainly by Roman-Dutch law as our common law.<sup>244</sup> The jurisprudence surrounding the notion of insurable interest is known as the “interest theory.”<sup>245</sup> The purpose of this doctrine which was developed by De Casaregis was to distinguish between insurance and wagers, but all that was concluded on the basis that a contract of insurance is an indemnity contract. To determine whether a contract of insurance was concluded, the traditional view in effect was that the tenor and contents of the terms of a contract were decisive and not the actual existence

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<sup>239</sup>Insurable interest in the context of long-term insurance <http://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&ved=2ahUKEwi3u979N94XgAhWVr3EKHVzRCxkQFjAEegQIBRAC&url=http%3A%2F%2Fwww.ombud.co.za%2Fdownload-attachment%2F2655&usq=AOvVaw3sXe60s3UwCmbxnOGracmp> (accessed 24 January 2019)

<sup>240</sup> “Insurance Focus” <http://www.nortonrosefulbright.com/knowledge/publications/105318/insurance-focus> (accessed 29 September 2017)

<sup>241</sup> Cape Act 8 of 1879 and Free State General Law Amendment Ordinance Act 5 of 1902

<sup>242</sup>Act 43 of 1977

<sup>243</sup> Marnewick CG Abandonment in Marine insurance law: An historical Comparative Study [https://researchspace.ukzn.ac.za/bitstream/handle/10413/9539/Marnewick\\_C\\_G\\_1996\\_Vol\\_2.pdf?sequence=2&isAllowed=y](https://researchspace.ukzn.ac.za/bitstream/handle/10413/9539/Marnewick_C_G_1996_Vol_2.pdf?sequence=2&isAllowed=y) (accessed 24 January 2019)

<sup>244</sup> *Rand Mutual Assurance Company Ltd v Road Accident Fund (2008)* ZASCA 114

<sup>245</sup> Atmeh SM “Regulation Not Prohibition: The Comparative Case Against the Insurable Interest Doctrine” Volume 32 Issue 1 *Northwestern Journal of International Law & Business*

of an insurable interest.<sup>246</sup> Any reference to interest was merely explanatory of the principle of indemnity. Indemnity insurance is where the actual loss of the insured is indemnified to the insured by the insurer. In non-indemnity insurance, the insurer agrees to pay a sum of money to an insured on the occurrence of an event.

Over the years, the importance was transferred from the terms of a contract to the existence or not of an insurable interest.<sup>247</sup> In the recent case of *Lorcom Thirteen (PTY) Ltd V Zurich Insurance Company South Africa*<sup>248</sup> the High Court had an opportunity to assess the correct approach to the question of insurable interest. In this case, a fishing vessel was lost at sea in 2008. The insurance company repudiated the claim on the basis of lack of insurable interest because the insured had no direct ownership interest in the vessel. The court examined the origins of the concept of insurable interest, which was in the Marine Insurance Act of 1745 and the English legislation on insurance and gambling. The court found that there was no South African legislation that laid the need for an insurable interest. According to the High Court, the issue was whether the contract was an enforceable contract of insurance or an unenforceable agreement of a wager. The distinction between a contract of insurance and betting agreement, is that, in an insurance contract the real interest of an insured is that the specific event should not have occurred.<sup>249</sup> Since the parties approached the court from the perspective of insurable interest and not an unenforceable wager, the court referred to the following cases: *Littlejohn V Norwich Union Fire Insurance Society*,<sup>250</sup> *Refrigerated*

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<sup>246</sup> Atmeh SM "Regulation Not Prohibition: The Comparative Case Against the Insurable Interest Doctrine" Volume 32 Issue 1 *Northwestern Journal of International Law & Business*

<sup>247</sup> See Reinecke 63 par [102]

<sup>248</sup> 2013 5 SA 42 (WCC)

<sup>249</sup> Bowley A "insurable interest, the indemnity principle and an unenforceable gamble" <http://www.polity.org.za/article/insurable-interest-the-indemnity-principle-and-an-unenforceable-gamble-2013-11-07> (accessed 29 September 2017)

<sup>250</sup> In *Littlejohn v Norwich Union Fire Insurance Society* 1905 TH 374. Judge Wessel's held that if parties are married out of community of property, in which the business belongs to the wife and the husband is managing the business. The husband has an insurable interest



*Trucking (Pty) Ltd V Zize NO*<sup>251</sup> and *Manderson t/a Hillcrest Electrical v Standard General Insurance Co Ltd.*<sup>252</sup> In the latter case, the judge considered the use of the concept to distinguish a wager from an enforceable contract to be in the realm of policy which is unhelpful to the jurisprudence of the interest theory. The judge approved the analysis that considers a wager to be where the risk of loss lies in the very making of the contract, while an insurance contract aims to indemnify the insured against loss of something already passed. Turning to the facts of the *Lorcom* case, the court found that a proper interpretation of the policy of insurance did not compel the insured to prove that it had suffered a patrimonial loss, but rather that there be loss or damage to the vessel. The court departed from this principle. This departure from the indemnity principle has a negative impact on insurance companies recovering monies under rights of subrogation and also warns insurance companies of the difficulties associated with rejecting a claim on the basis of an absence of insurable or an unenforceable gamble.<sup>253</sup> Therefore, the lesson from the *Lorcom* case is that insurers must consider when entering into an insurance contract, the nature of the interest and the relationship that the interest has in order to be indemnified under the policy. These considerations must be made at the inception of the insurance contract.

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<sup>251</sup> 1996 (2) (T) 361

<sup>252</sup> 1996 (3) SA 434

<sup>253</sup> Webber Wenzel Insurable Interest, the indemnity principle and an unenforceable gamble. <http://www.polity.org.za/article/insurable-interest-the-indemnity-principle-and-an-unenforceable-gamble-2013-11-07> (accessed 24 January 2019)

## 4.4 THE REGULATORY FRAMEWORK OF SOUTH AFRICAN LAW OF INSURANCE

Historically a contract of insurance was defined by Roman-Dutch authorities as a contract to transfer risk threatening the patrimony of the insured.<sup>254</sup> Insurance is implemented by the conclusion of a contract. In *Lake V Reinsurance Corporation Ltd*<sup>255</sup> the following definition of a contract was adopted in South African law 'A contract between an insurer (or assurer) and an insured (or assured), whereby the insurer undertakes in return for the payment of a price or premium to render to the insured a sum of money, or its equivalent, on the happening of a specified uncertain event in which the insured has some interest.'

Nonetheless, the Long-Term Insurance Act 52 of 1998 and the Short-Term Insurance Act 53 of 1998 do not define an insurance contract.

### 4.4.1 Short-Term Insurance Act

The aim of the Short Term Insurance Act is to provide for the registration of short-term insurers and for the control of certain activities of short-term insurers and intermediaries. A short-term insurance business as defined by the Act means that the business of providing or undertaking to provide policy benefits under short-term policies.<sup>256</sup> The term short-term policies provide policy benefits under an accident and health policy, a property policy, a

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<sup>254</sup> CJ Marnewick "Abandonment in Marine insurance law: A Historical and comparative study" (LLD Thesis UKZN 1996)

[http://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=0ahUKEwi05J\\_i k8rWAhUNixQKHWUUC4kQFggyMAI&url=http%3A%2F%2Fresearchspace.ukzn.ac.za%2Fxmliui%2Fbitstream%2Fhandle%2F10413%2F9539%2FMarnewick\\_C\\_G\\_1996\\_Vol\\_2.pdf%3Fsequence%3D2&usq=AFQjCNF0HzYsrYOG4EKr4mvOE1Wyp3f3g](http://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&ved=0ahUKEwi05J_i k8rWAhUNixQKHWUUC4kQFggyMAI&url=http%3A%2F%2Fresearchspace.ukzn.ac.za%2Fxmliui%2Fbitstream%2Fhandle%2F10413%2F9539%2FMarnewick_C_G_1996_Vol_2.pdf%3Fsequence%3D2&usq=AFQjCNF0HzYsrYOG4EKr4mvOE1Wyp3f3g) (accessed 29 September 2017)

<sup>255</sup> An insurance contract was defined in *Lake V Reinsurance Corporation Ltd* 1967 (3) SA 124 (W)

<sup>256</sup> Defined in Section 1 (1) of the Act

transportation policy, a liability policy, miscellaneous policies, a motor policy and it also includes contracts that combine the above-mentioned policies. A “premium” is defined in that Act to mean the consideration given or to be given in return for an undertaking to provide policy benefits.<sup>257</sup> These policies must be taken to be contracts of insurance unless a different intention is made evident. The definition of a policy has not been included in the Act but the Act stipulates that the policy is a document embodying a contract of insurance. When defining the different types of policies, the Act refers to contracts, which contracts are not limited to written contracts. Therefore a policy embraces oral and written contracts.

#### **4.4.1.1 Products of Short-Term Insurance**

The short-term risks covered by a short-term insurer depend on the policy classes for which the insurer is registered. The following policy classes are defined under the Short-term Insurance Act and are categorised in the classes of commercial, business and industrial and personal policies.<sup>258</sup>

The policies as defined in terms of the short-term insurance Act include accident and health policies, engineering policy, guarantee policy, transportation policy, motor policy, property policy, liability policy and miscellaneous policy.<sup>259</sup>

##### **4.4.1.1.1 Accident and Health Policies**

Accident and Health policies refers to a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits for the occurrence of a disability, health or death event. In terms of this contract a person pays a premium to a policy insurer and such insurer undertakes to provide policy

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<sup>257</sup> Ibid

<sup>258</sup> Defined in Section 1 (1) of Short-Term Insurance Act 53 of 1998

<sup>259</sup> Ibid

benefits on the occurrence of a disability event, a health event or a death event.<sup>260</sup> The definition is wide enough to include a personal accident insurance contract under common law. This means that the insurer may bind itself to pay a sum of money if the insured dies in an accident or is seriously injured in such accident which leads to death. The insurer may pay a sum of money if the insured loses a limb or sight of both or one of his eyes. The exception to this risk is that the insured will not be able to recover in the case of a “deliberate exposure to exceptional danger,” death or injury resulted from intoxication, suicide and a contravention of criminal law.<sup>261</sup>

#### **4.4.1.1.2 Engineering Policy**

An engineering policy refers to ‘a contract in terms of which a person, in return of a premium, undertakes to provide policy benefits if an event contemplated in the contract as a risk relating to the possession, use or ownership of machinery or equipment, other than a motor vehicle, in the carrying on of a business; the erection of buildings or other structures or the undertaking of other works; or the installation of machinery or equipment occurs and includes a reinsurance policy in respect of such a policy.’<sup>262</sup>

In terms of this definition an insurer undertakes to provide for policy benefits after receipt of premiums. There must be an occurrence of a risk which relates to the possession, use or ownership of machinery or equipment except a motor vehicle, in the carrying on of a business, erection of buildings, structures and the installation of machinery and equipment. A reinsurance policy is also included in the definition.<sup>263</sup>

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<sup>260</sup> Solvency assessment and management  
<https://www.fsb.co.za/Departments/.../SAM%202015%20Update.pdf> (accessed 15 May 2014)

<sup>261</sup> Personal Accident personal liability risk all risk South African insurance  
<https://www.saia.co.za/personal-accident.pdf> (accessed 24 January 2019)

<sup>262</sup> Ibid

<sup>263</sup> Ibid

#### **4.4.1.1.3 Guarantee Policy**

A guarantee policy means a contract in terms of which a person, other than a bank, in return for a premium, undertakes to provide policy benefits if an event, contemplated in the policy as a risk relating to the failure of a person to discharge an obligation, occurs. This also includes a reinsurance policy in respect of such a policy.<sup>264</sup> This is an insurance contract whereby any person except a bank, in return of a premium provides policy benefits, if an event relating to the failure of a person to discharge an obligation occurs.<sup>265</sup>

#### **4.4.1.1.4 Transportation Policy**

A transportation policy means a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits. This occurs if an event, contemplated in the contract as a risk relating to the possession, use or ownership of a vessel, aircraft or other craft or for the conveyance of persons or goods by air, space, land or water, or to the storage, treatment or handling of goods so conveyed or to be so conveyed, occurs; and includes a reinsurance policy in respect of such a policy.<sup>266</sup>

#### **4.4.1.1.5 Motor Policy**

A motor policy means a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits. This occurs if an event, contemplated in the contract as a risk relating to the possession, use or ownership of a motor vehicle, occurs; and includes a reinsurance policy in respect of such a policy.<sup>267</sup> In terms of this policy, a person in return for a

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<sup>264</sup> Ibid

<sup>265</sup> See, Solvency assessment and management <https://www.fsb.co.za/Departments/insurance/Documents/Discussion%20Document%2029%20%28v%209%29.pdf> (accessed 20 May 2015)

<sup>266</sup> Ibid

<sup>267</sup> As stated in the Short term insurance Act.

premium undertakes to provide policy benefits if a risk relating to the possession, use or ownership of a motor vehicle occurs. This is a contract of indemnity insurance which is concerned with the cover of a particular asset and liability. The principles of interpretation and subrogation<sup>268</sup> are also applied. The extension clause and the warranty requiring maintenance of the vehicle in an efficient condition are also applied.

#### **4.4.1.1.6 Property Policy**

A property policy means a contract in terms of which an insurer, in return for a premium, undertakes to provide policy benefits if an event, contemplated in the contract as a risk other than a risk more specifically contemplated in another definition in this section relating to the use, ownership, loss of or damage to movable or immovable property occurs; and includes a reinsurance policy in respect of such a policy.<sup>269</sup> This is a contract in terms of which an insurer in receipt of a premium undertakes to provide policy benefits if a risk relating to the use, ownership loss or damage to an immovable or movable property materialises. This risk will only be considered if it is not covered more specifically by another definition in the short-term Insurance Act.<sup>270</sup>

#### **4.4.1.1.7 Liability Policy**

A liability policy means a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits if an event, contemplated in

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<sup>268</sup> Subrogation is a process that is carried out by insurance brokers wherein the insurer is permitted, on behalf of the claimant/insured, to sue a third party that was responsible for a loss suffered by the insured. Subrogation in South Africa is applied in much the same way as it is in any other country. A case for subrogation exists in almost every instance where the claimant is due to be paid a sum of money by the insurer. It can often happen that two insurance companies will contest the dispute as to who was responsible for the loss, while their clients (the insured parties) remain free from financial liability <http://www.chadwicks.co.za/index.php?pid=100036&sid=1> (accessed 11 May 2015).

<sup>269</sup> Ibid

<sup>270</sup> As stated in the Short Term insurance Act 53 of 1998

the contract as a risk relating to the incurring of a liability, otherwise than as part of a policy relating to a risk more specifically contemplated in another definition in this section, occurs; and includes a reinsurance policy in respect of such a policy.<sup>271</sup> This is insurance in terms of legal liability. The liability may arise from a contract, for example, an insurance broker covers himself against liability for not performing his obligations under a contract. Liability insurance is a contract of indemnity insurance.<sup>272</sup> The liability insured against must be described in the policy but usually, there are limitations imposed upon the amount recoverable under such policy

#### **4.4.1.1.8 Miscellaneous Policy**

A miscellaneous policy means a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits if an event, contemplated in the contract as a risk relating to any matter not otherwise defined in this section, occurs; and includes a reinsurance policy in respect of such a policy.<sup>273</sup> This provides for policies not covered under the definition of the Act. Therefore this is a contract in terms of which a person, after receipt of a premium undertakes to provide policy benefits if a risk relating to any matters not defined occurs. A reinsurance policy is also included.<sup>274</sup>

#### **4.4.2 The Long-Term Insurance Act 52 of 1998**

The aim of the Long-Term Insurance Act is to ensure that policies that are entered into executed and enforced in accordance with sound insurance principles and practice in the interests of the parties and in the public interest. The “long term insurance business” means the business of providing or

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<sup>271</sup> Ibid

<sup>272</sup> Boshoff v South British Insurance Company Ltd 1951 (3) SA 481 (T) 487 C-D

<sup>273</sup> Defined in the Short-Term Insurance Act 53 of 1998

<sup>274</sup> Ibid

undertaking to provide policy benefits under long-term policies. The intention of the business is to provide cover for a long period, generally longer than 5 years.<sup>275</sup>

#### **4.4.2.1 Products in terms the Long Term Insurance Act 52 of 1998**

The long-term risks covered by a long term insurer depend on the policy classes for which the insurer is registered. The policy classes which are defined under the Long-term Insurance Act include assistance policies, life policies, disability policies, health policies, fund policies, sink fund policies.

##### **4.4.2.1.1 Assistance Policies**

In terms of the common law, these policies are referred to funeral policies. A funeral policy is either a contract of indemnity or of capital insurance. An insurer receives a premium and undertakes to provide the policy-holder with a sum of money upon the death of such policy-holder. If the sum of all benefits to be provided under a life policy, or the annuity premium in the case of an annuity, does not exceed R30 000, these risks can be also written in assistance policies.<sup>276</sup>

##### **4.4.2.1.2 Disability Policy**

This is a contract whereby an insurer receives a premium and undertakes to provide a policy benefit upon the occurrence of a disability event. A disability even as defined in the Act<sup>277</sup> is an event which impairs the functional ability of the mind or body of a person or an unborn. Policies that insure or reinsure these risks are disability policies.<sup>278</sup>

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<sup>275</sup> Ibid

<sup>276</sup> Ibid

<sup>277</sup> As defined in the Long-Term Insurance Act under S 1 (1) "disability event"

<sup>278</sup> Ibid



#### **4.4.2.1.3 Fund Policy**

This is a contract whereby an insurer receives a premium and undertakes to provide benefits. The purpose of the benefit is to fund, in whole or in part the liability of a fund to provide benefits to its members in terms of the rules. Funds whose liabilities may be underwritten by a fund policy are friendly societies, pension funds, medical schemes, and a permanent fund.

#### **4.4.2.1.4 Health Policy**

This is a contract whereby an insurer receives a premium and undertakes to provide a benefit upon an event relating to the health of the mind or body of a person or unborn.<sup>279</sup> Policies that insure and reinsure these risks are health policies unless:

- a) The benefits are not defined amounts of money.
- b) The benefits are provided by a person having incurred expenses in respect of any health services, to defray these expenses.
- c) The benefits are to be provided to a provider of health services in return for providing such services.
- d) A policy is a fund policy as defined above.

#### **4.4.2.1.5 Sinking Fund Policy**

This is a contract whereby an insurer receives a premium and undertakes to provide sums of money on a fixed future date. Policies that insure or reinsure these risks but fall outside this definition are sinking fund policies.<sup>280</sup>

#### **4.4.2.1.6 Life Policy**

Life Insurance developed in the seventeenth century and was regarded as suspicious. Such insurance contracts were prohibited by Roman-Dutch law. It

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<sup>279</sup> Ibid

<sup>280</sup> Ibid

was the act of wagering on lives that were prohibited. There is not much authority on life insurance by Roman-Dutch law, therefore, life insurance is influenced by foreign law. In terms of common law, attempts have been made to define a contract of life insurance and it is seen as a contract of insurance in its ordinary sense.<sup>281</sup> In a contract of life insurance, the insurer undertakes to pay a certain or ascertainable sum of money at a specific time or make payments during interval periods. The distinctive feature of the contract of life insurance is the payment of a sum of money which is dependent on an occurrence of a life event. It is insurance on a subject of life. There is an obligation on the insurer's part to pay benefits if the life of the insured continues to a certain date or age, as an obligation to pay benefits if life ceases. The insured does not seek compensation for a loss. And such policy may be ceded to another person in full, or to a financial institution as security for a loan.<sup>282</sup>The prudential requirements in the Long-Term and Short-term Insurance Act have been repealed by the Insurance Act.<sup>283</sup>The Insurance Act<sup>284</sup> establishes a legal framework for the prudential regulation and supervision of insurers in terms of the Twin Peaks framework. The next section will discuss the importance of compliance, governance and risk management. This is necessary to ensure protection for insurers, policy holders and to achieve stability in the financial system.

#### **4.5 The Importance of Compliance, Governance and Risk Management in SA Insurance**

In this time and age, some risks decrease while new risks appear. The world, in which we live needs to assess and manage risk, because it is volatile and

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<sup>281</sup> *Prudential Insurance Co V Inland Revenue Commissioners* (1904) 2 KB 658 665

<sup>282</sup> Ibid

<sup>283</sup> 18 of 2017

<sup>284</sup> 18 of 2017

turbulent due to the interconnectivity and interdependence of its elements. The speed at which a threat emerging in one environment can spread to disrupt remote systems and markets and can become apparent to millions of people via the internet and broadcast media. Such advances in communication cause an increase in global trade and financial flows, therefore there is more co-operation and competition. This connection amongst firms, markets and the states have increased to such an extent that the effects and unintended consequences are felt more rapidly.<sup>285</sup>

Risk management is determined by the behaviour of markets in terms of contractual agreements. The perceptions of risks are frequently shaped by the often dramatic reports of global broadcasters.<sup>286</sup> Risk management and monitoring are not problem-solving techniques but should be seen as proactive techniques for obtaining objective information to prevent the occurrence of adverse events or to minimise their negative impact.<sup>287</sup> Many risks can be transferred, for example, by means of insurance. But regardless of whether or not a risk can be transferred, it has to be identified if it is to be managed.

Due to the environmental factors such as recession and the increasing socio-economic challenges, the South African economy is challenged with the high levels of personal debt and security concerns. The consumers, government and policy makers must work together in order to obtain the long term sustainable growth.<sup>288</sup> Risk management provides for opportunities for

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<sup>285</sup> World Economic Situation and Prospects [https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/WESP2018\\_Full\\_Web-1.pdf](https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/WESP2018_Full_Web-1.pdf) (accessed 28 January 2019)

<sup>286</sup> Joosub TS Risk Management Strategies to Maintain Corporate Reputation <https://core.ac.uk/download/pdf/43165895.pdf> (accessed 28 January 2019)

<sup>287</sup> See Harvard Business Review Management <https://hbr.org/2012/06/managing-risks-a-new-framework> (accessed 24 January 2019)

<sup>288</sup> See, South Africa's Economic Overview <http://www.treasury.gov.za/documents/national%20budget/2018/review/Chapter%202.pdf> (accessed 24 January 2019)

sustainable practices therefore a brief discussion of risk management will follow.

#### **4.5 Risk Management and South African Law**

The world is interrelated and marked by transformation and complications, therefore successful risk management is an important element for survival and success.<sup>289</sup> A risk refers to the uncertainty that surrounds future events and outcomes. It is the “expression of the likelihood and impact of an event with the potential to influence the achievement of an organisation's objectives.”<sup>290</sup>The “phrase the expression of the likelihood and impact of an event’ implies that, at a minimum, some form of quantitative or qualitative analysis is required for making decisions concerning major risks or threats to the achievement of an organisation's objectives.”<sup>291</sup>

Commercial insurance began over 300 years ago and developed into a service which provides for the funding of sudden and unforeseen losses. The 20<sup>th</sup> century has been marked by an increase in crime and political disharmony which forced businesses to adopt systems to prevent loss and to control procedures. In South Africa, legislation was enacted which includes the Public Finance Management Act<sup>292</sup>and the Municipal Finance Management Act.<sup>293</sup> The key objectives of the legislation are to modernise the system of financial management in the public sector. Public sector manager must also be held more accountable, ensure the timely provision of

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<sup>289</sup> Cleary S and Malleret T “Resilience to Risk; Business success in turbulent rimes” (2010)

<sup>290</sup> Heinz-Peter Berg “Risk Management: Procedures, methods and experiences” (2010)

<sup>291</sup> Ibid

<sup>292</sup> Act 1 of 1999.

<sup>293</sup> Act 56 of 2003.

quality information and to eliminate the waste and corruption in the use of public assets.<sup>294</sup>

Section 215 to 219 of the *Constitution* requires “national legislation to establish a national treasury, to introduce uniform treasury norms and standards, to prescribe measures to ensure transparency and expenditure control in all spheres of government, and to set the operational procedures for borrowing, guarantees, procurement and oversight over the various national and provincial revenue funds.”<sup>295</sup>

#### **4.6.1 Conflict of Interest**

In term of the Financial Advisory and Intermediary Services Act 37 of 2002 (FAIS), all financial services providers (FSPs)<sup>296</sup> are required to formalise and document detailed policies to ensure that “conflict of interest” would be avoided and where avoidance is not possible they are mitigated (managed) and all associated disclosures are made to customers.<sup>297</sup> A conflict of interest arises when a financial representative has a business and personal interest that compete with each other. A “conflict of interest” means any situation in

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<sup>294</sup> The National Treasury is responsible for managing South Africa's national government finances.

Supporting efficient and sustainable public financial management is fundamental to the promotion of economic development, good governance, social progress and a rising standard of living for all South Africans. The Constitution of the Republic (Chapter 13) mandates the National Treasury to ensure transparency, accountability and sound financial controls in the management of public finances <http://www.treasury.gov.za/legislation/pfma/> (accessed 12 January 2015).

<sup>295</sup> Ibid

<sup>296</sup> Financial service provider means “any person, other than a representative, who as a regular feature of the business of such person (a) furnishes advice; or (b) furnishes advice and renders any intermediary service; or (c) renders an intermediary service”

<sup>297</sup> Conflict of Interest management policy in terms of The FAIS general code of conduct [https://www.africanbank.co.za/resources/media/pdf/african\\_bank\\_conflict\\_of\\_interest\\_management\\_policy.pdf](https://www.africanbank.co.za/resources/media/pdf/african_bank_conflict_of_interest_management_policy.pdf) (accessed 2 February 2015)

which a person has an actual or potential interest that may, in rendering a financial service to a client.<sup>298</sup>

a) Influences, the objective performance of their obligations towards such client.<sup>299</sup>

b) Prevents a person from rendering an unbiased and fair financial service to that client, or from acting in the interests of that client, including but not limited to a financial interest; an ownership interest and any relationship with a third party.<sup>300</sup>

All financial service providers must be committed to ensuring that all business is conducted in accordance with the standards of good corporate governance. The manner in which they conduct business must be based on integrity and ethical and equitable behaviour. A conflict of interest policy aims to emphasise the interests of all stakeholders by minimising and managing all actual or potential conflicts of interest.<sup>301</sup>

Financial service providers are potentially exposed to a conflict of interest in relation to various activities. However, the protection of the client's interests is the primary concern. Therefore, circumstances must be identified which may give rise to an actual or potential conflict of interest entailing a material risk of damage to clients' interests, the establishment of appropriate structures and systems to manage this conflict and also the maintenance of systems in an

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<sup>298</sup> FAIS conflict of interest management policy [http://www.hrsinsurance.co.za/wp-content/uploads/2014/07/HRS\\_FAIS-Conflict-of-Interest-Management-Policy\\_16-April-2014.pdf](http://www.hrsinsurance.co.za/wp-content/uploads/2014/07/HRS_FAIS-Conflict-of-Interest-Management-Policy_16-April-2014.pdf) (accessed 20 May 2015)

<sup>299</sup> Ibid

<sup>300</sup> Statutory definition of conflict of interest et al HRS Insurance services FAIS conflict of interest management policy. [http://www.hrsinsurance.co.za/wp-content/uploads/2014/07/HRS\\_FAIS-Conflict-of-Interest-Management-Policy\\_16-April-2014.pdf](http://www.hrsinsurance.co.za/wp-content/uploads/2014/07/HRS_FAIS-Conflict-of-Interest-Management-Policy_16-April-2014.pdf) (accessed 2 February 2015)

<sup>301</sup> Conflict of interest management policy <http://www.sanlam.com/legal/Documents/Coris%20Capital%20%28PTY%29%20LTD%20Policy.pdf> (accessed 20 May 2015)

effort to prevent damage to clients' interests through identified conflict. Once a conflict of interest has been identified, it must be appropriately and adequately managed and steps must be taken to avoid such a conflict and should such avoidance not be possible, steps must be taken to mitigate such an actual or potential conflict of interest and must be disclosed to all impacted parties. The FAIS Act provides for penalties in the event that a person is found guilty of contravening the Act, or of non-compliance with the provisions of the Act. The penalty for non-compliance of specific provisions of the Act is an amount of up to R1 million or a period of imprisonment for up to 10 years.<sup>302</sup> The registrar of FAIS is empowered to refer instances of non-compliance to an enforcement committee of the FSB that may impose administrative penalties on offenders. The FAIS Act also gives the Registrar the powers to revoke the license of an FSP.<sup>303</sup>

#### **4.6.2 The Business Code of Ethics in South Africa**

Business ethics is a set of moral principles that distinguish between right and wrong. It is a normative field because it prescribes what one should do or abstain from doing. What is ethical behaviour depends on factors such as legal interpretation for example the Financial Advisory and Intermediary Services Act contains a code of ethics, organisational factors for example policy statements and individual factors such as different people have different values.<sup>304</sup> It is also about identifying and implementing codes of conduct that will ensure that the interests of the business will be enhanced. The Financial Service Board as the regulator in South Africa gave legal effect to many ethical principles by issuing codes of conduct as subordinate legislation. In terms of the Financial Advisory and Intermediary Services Act,

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<sup>302</sup> The FAIS Act <https://www.fsb.co.za/feedback/Documents/Financial%20Advisory%20and%20Intermediary%20Services%20%28FAIS%29%20Act.pdf> (accessed 20 May 2015)

<sup>303</sup> Ibid

<sup>304</sup> Ibid

2002 (FAIS), codes of conduct are issued and their aim is to disclose requirements and needs analysis. The general code of conduct has special codes for different players in the financial industry. Such code contains provisions that define and control conflicts of interest which have an impact in a business sector and all other financial companies.

The policy documents for the South African legal framework have four policy objectives which are financial stability, consumer protection and market conduct, expanding access through financial inclusions and combating financial crime.

The legislation requirements which pertain to policyholders' protection rules means that a marketer must render services honestly, fairly and with due skill, care and diligence and be professional at all times. In terms of the provisions in the Act, disclosures must be made and records are kept. All intermediaries must be licenced under the FAIS Act before they sell products. A consumer can cancel a contract and receive a refund of his premiums within 30 days after signing.<sup>305</sup> In reference to assistance business groups, an insurer may only do business with a group scheme or administrator if there is a written agreement with such scheme.<sup>306</sup>

In terms of the FAIS code of conduct, a financial service provider<sup>307</sup> must:

- a) At all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry.
- b) At the earliest reasonable opportunity furnish the client with the relevant information.
- c) Where the relevant licence, terms of employment or mandate enables such provider to provide clients with financial services in respect of a

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<sup>305</sup> Board notice 80 of 2003 of the FAIS Act <http://www.banking.org.za/docs/default-source/default-document-library/financial-advisory-and-intermediary-services-act-37-2002.pdf?sfvrsn=8> (accessed 20 May 2015)

<sup>306</sup> Ibid

<sup>307</sup> Ibid



choice of product suppliers, exercise judgment objectively in the interest of the client concerned.

- d) When making contact arrangements, and in all communications and dealings with a client, act honourably, professionally and with due regards to the convenience of the client.
- e) Provide a reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision.
- f) Take reasonable steps to seek from the client appropriate and available information regarding the client's financial situation, financial product experience and objectives to enable the provider to provide the client with appropriate advice.

The drafting of a code conduct must be in such a manner as to ensure that the clients being rendered financial services will be able to make an informed decision and that their financial needs will be satisfied.<sup>308</sup>

All financial providers and their representatives must.<sup>309</sup>

- a. Act honestly and fairly, and with due skill, care and diligence, in the interests of clients and the integrity of the financial service industry.
- b. Have and employ effectively the resources, procedures and appropriate technology systems for the proper performance of professional activities.
- c. Seek from clients appropriate and available information regarding their financial situations, financial product experience and objectives in connection with the financial service required.

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<sup>308</sup> Ibid

<sup>309</sup> Section 16 (1) of the FAIS Act

- d. Act with circumspection and treat clients fairly in a situation of conflicting interests.
- e. Comply with all applicable statutory or common law requirements applicable to the conduct of the business.

The codes of conduct must in particular contain the following provisions<sup>310</sup>

- a) Making adequate disclosures of important information.
- b) Adequate and appropriate record keeping.
- c) Avoidance of fraudulent and misleading advertising, canvassing and marketing.
- d) Proper safe-keeping, separation and protection of funds and transaction documentation of clients.
- e) Where appropriate, suitable guarantees or professional indemnity or fidelity insurance cover, and mechanisms for adjustments of such guarantees or cover by the registrar in any particular case.<sup>311</sup>
- f) The control or prohibition of incentives given or accepted by a provider.<sup>312</sup>
- g) Any other matter which is necessary or expedient to be regulated in such code for the better achievement of the objects of the Act.

There must be an established written compliance policy which sets the organisations commitment and approach to compliance. The compliance policy is intended to formally communicate the organisation's philosophy and approach to the management of compliance risk and function.<sup>313</sup>

It recognises governance which filters all levels of the organisation that a compliance policy statement exists which sets out the company's commitment

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<sup>310</sup> Section 16 of the FAIS Act

<sup>311</sup> Amended by section 56 of Act 22 of 2008

<sup>312</sup> Ibid

<sup>313</sup> Co-operative governance and Traditional affairs <http://cgta.mpg.gov.za/policies/2014-15%20Policies/riskManag14-15.pdf> (accessed 25 May 2015)

and approach to compliance, responsibility of management is to ensure that the compliance policy is implemented and supported and that they are responsible for the endorsement of the compliance policy and the compliance charter granting the compliance function its status and authority. It requests that the governance structure must be implemented. This facilitates the management's awareness of laws and regulatory requirements. They should be kept up to date with changes in the regulatory environment as they affect the organisation. The compliance function must be part of the overall risk management framework. The framework must be reviewed and lined with the organisation's strategic goals.<sup>314</sup>

#### **4.6.3 The Triple Bottom Line and Micro-*Takaful***

In today's times many organisations must make sustainable decisions about interests of stakeholders, finances as well as the economy. Organisations must consider the triple bottom line. The triple bottom line refers to "financial, social and environmental effects of a firm's policies and actions that determine its viability as a sustainable organisation."<sup>315</sup> The triple bottom line is defined as "a process which assists in the process of identifying, assessing and reporting on an individual company business activities in terms of its impact on society, the environment and economic sustainability."<sup>316</sup> It also entails the confronting of basic issues around the core values of a company and consistent application of a company's core values to all its activities. The concept of sustainability has recently been recognised and adopted in a business context to mean the achievement of balanced and integrated economic, social and environmental performance ("triple bottom line"). King II attempts to provide an expressive standard to South African companies who

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<sup>314</sup> Ibid

<sup>315</sup> Definition of the triple bottom line <http://www.businessdictionary.com/definition/triple-bottom-line.html> (accessed 3 February 2015)

<sup>316</sup> King Report on corporate governance in South Africa (2002) [http://www.mervynking.co.za/downloads/CD\\_King2.pdf](http://www.mervynking.co.za/downloads/CD_King2.pdf) (accessed 25 May 2015)

are attempting to enhance their disclosure application and also acknowledges on the significance of the relationship between businesses and the community.<sup>317</sup> The King 11 has recognised that the purpose of companies involve the integration of safety, health and environment which will allow the company to achieve the triple bottom line goals.

In Muslim societies, Islamic Micro *Takaful* and Micro Finance has been regarded as an important tool for the empowerment of poor people especially woman. The purpose of *Takaful* is to focus on countries like South Africa in which there are a high incidence of poverty. Insurance for low-income populations, or micro insurance, is now firmly accepted as an integral tool for poverty alleviation and building resilience in communities against natural and manmade disasters. This will provide financial and social security to the poor. Micro-Takaful insurance as well is an incentive for the protection of and financing of micro enterprises and low income families. Without the protection of loss, many South African families will remain in or fall into poverty. Micro *Takaful* can provide a safety net for communities to achieve sustainable development by providing security and dignity.<sup>318</sup>

#### **4.7 The Secondary Legal Framework regulating the financial industry**

In the late eighties and early nineties, the South African financial market was involved in a number of scandals such as the collapse of the Master bond scam.<sup>319</sup> The scam resulted in the loss of R600 million and had a devastating

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<sup>317</sup>Hendrikse J and Leigh Hendrikse L '*Business governance Handbook: Principles and practice* 'Volume 1 (2004) at 127

<sup>318</sup> Serapo GA *Takaful* and Mutual Insurance: Alternative Approaches to Managing Risks at 167

<sup>319</sup>The Honourable Mr Justice H.C Nel the Final report of the commission of inquiry into the affairs of the Master Bond Group and Investor protection. "One of the failures during the early nineties, was the Master bond Group of Companies which over a number of years had attracted approximately a billion rand by promising secured and thus seemingly safe investments. More than 90 percent of the money borrowed on short-term was used within the group and associated companies for highly speculative long-term projects, which generated little or no return. It soon degenerated into little more than a Ponzi scheme. The Group collapsed and thousands of investors were left destitute, many of them pensioners who

effect on the parties involved. The financial industry was also extremely unprofessional because the industry was open to any person who neither had skills, qualifications or knowledge. This resulted in poor advice given to clients, fraud, scams, scandals and many investors never ever recovered financially from these effects. Clients who felt that they received improper advice from insurance agents had to seek recourse in the formal court system and many did not have the financial means to access the court system.<sup>320</sup> Therefore a gap existed for a more expeditious and cost effective method to resolve complaints. Another issue was that the players in the financial field where also governed and regulated by different statutes and this was to the detriment of a consumer. The different regulations were as follows:

- a) Banks are regulated by the Banks Act, 94 of 1990.
- b) Long-term insurers are regulated by the Long-term Insurance Act 52, of 1998.
- c) Short-Term insurers are regulated by the Short-term Insurance Act, 53 of 1998.
- d) Collective investments are regulated by the Collective Investment Schemes Control Act, 45 of 2002.
- e) Disclosures to clients were regulated by the Policyholder's Protection Rules, issued in terms of the Long-term Insurance Act, 52 of 1993.
- f) Retirement funds are regulated by the Pension Funds Act, 24 of 1956.
- g) Medical schemes are regulated by the Medical Schemes Act 113 of 1998.

The Nel Commission of Inquiry<sup>321</sup>recommended that South Africa requires stronger legislation to govern the financial industry and this resulted in the

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specifically had been targeted and tempted with the twin carrots of security and higher than normal interest rates." South Africa Volume 1 (2001)

<sup>320</sup> Ombudsman South Africa <http://www.ombud.co.za/how-to-complain> (accessed 25 May 2015)

<sup>321</sup> Nel Commission of inquiry into affairs of Master bond Group and investor protection in South Africa <http://www.gov.za/documents/nel-commission-inquiry-affairs-masterbond-group-and-investor-protection-south-africa> (accessed 25 May 2015)

introduction of the Financial Advisory and Intermediary Services Act 37 of 2002 which is referred to as the FAIS Act. The Act became effective on the 30 September 2004 and its purpose is to regulate the rendering of all financial advisory and intermediary services to clients. The main objective of the FAIS Act is to protect customers in relation to financial services. The Act follows a functional approach in that the Act regulates certain functions across institutions such as insurance companies, brokerages and banks. The functions include the approval of key individuals and compliance officers, whether they comply with requirements relating to fit and proper conduct and the power to enforce the Act and to impose penalties.

#### **4.7.1 The Financial Intelligence Centre Act**

One of the most important pieces of legislation having an impact on the financial services in South Africa including the insurance industry is the FICA legislation which is aimed at controlling money laundering in particular. The objective of the Act is as follows: “To establish a Financial Intelligence Centre and a Counter-Money Laundering Advisory Council in order to combat money laundering activities and the financing of terrorist and related activities; to impose certain duties on institutions and other persons who might be used for money laundering purposes and the financing of terrorist and related activities; to clarify the application of the Act in relation to other laws; to provide for the sharing of information by the Centre and supervisory bodies; to provide for the issuance of directives by the Centre and supervisory bodies; to provide for the registration of accountable and reporting institutions; to provide for the roles and responsibilities of supervisory bodies; to provide for written arrangements relating to the respective roles and responsibilities of the Centre and supervisory bodies; to provide the Centre and supervisory bodies with powers to conduct inspections; to regulate certain applications to Court; to provide for administrative sanctions that may be imposed by the Centre and supervisory bodies; to establish an appeal board to hear appeals against decisions of the Centre or supervisory bodies; to amend the Prevention of Organised Crime

Act, 1998, and the Promotion of Access to Information Act, 2000; and to provide for matters connected therewith.”<sup>322</sup>

Therefore, the South African government created the Act to combat terrorism, prevent money laundering and the financing of terrorist activities. The money laundering stages consist of, placement, layering and integration. The placement stage is where cash derived from a criminal activity is first placed into the system through a financial institution or is used to buy an asset. The layering stage is the criminal’s first attempt to conceal or disguise the source of the ownership of the funds and the integration stage is where money is integrated into the legitimate economic and financial system and is assimilated with all other assets in the system.<sup>323</sup> Illegal activities at all of these are common in banking, securities, and insurance and microfinance sectors of the economy. The insurance industry, in particular, can be used for money laundering for example where a person purchases a single premium policy and receives a pay out after a while, say two years and the receipt under the policy will become ‘white-washed’ with documentary evidence of it being lawfully received. These actions have been criminalised in section 4 of the Prevention of Organised Crime Act 1998.<sup>324</sup> This piece of legislation also introduces a regulatory framework of measures concerning client identification, record-keeping, reporting of information and internal compliance structures. These requirements apply to a broad range of financial and non-financial institutions and define the anti-money laundering responsibilities of supervisory bodies.<sup>325</sup> In terms of FICA, all accountable institutions have

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<sup>322</sup> See, the title of the FICA

<sup>323</sup> Money laundering, Financial Service Board Newsletter Volume 6 (2008)

<sup>324</sup> *S V Goodwin* (2010) ZAWHC 579. The broker pleaded guilty to the receiving of illegally gained profits which was related to the Fidentia Group of companies. The court sentenced the accused to 15 years for money laundering whereby 7 years were suspended

<sup>325</sup> FATF/ESAAMLG old mutual evaluation report  
<https://www.fic.gov.za/downloadcontent/resources/annualreport/FIC%20annual%20report%2020092010.pdf> 2009 (accessed 22 January 2014)

specific duties to help prevent money laundering and to perform a “Know-Your Customer” check on all clients. There are many money laundering compliance obligations for persons and institutions such as businesses, accountable institutions,<sup>326</sup>reportable institutions<sup>327</sup>and international travellers whose intention is to bring cash or a negotiable instrument in excess of the prescribed amount which is currently R24 999.00<sup>328</sup> to and from South Africa.<sup>329</sup>

#### **4.8 Chapter Conclusion**

The majority of the complaints in the South African financial sector are for long-term and short-term insurance. Against this background, on-going efforts to strengthen the oversight of market conduct abuses in both sectors are of utmost importance. South Africa is committed to the highest standard for regulating the financial sector.assist the South African government in advocating and developing a regulatory regime for Islamic finance.<sup>330</sup>

Islamic financial products as compared to its conventional financial counterpart identified dissimilarities that exist between Islamic and conventional finance. The functions of both these institutions are similar in nature, the practice and methods of conveyance and the discharge of its

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<sup>326</sup> Accountable institutions are listed on schedule 1 of the FICA Act as amended by Government Notice 1104 of 2011, published *in Government Gazette* 33781 of 26 (2010)

<sup>327</sup> Reportable institutions are defined in s 1 of the FICA Act as those who are listed in schedule 3 of FICA

<sup>328</sup> Section 28 of FICA makes it obligatory for all accountable institutions and reporting institutions to report cash transactions above the prescribed limit. Failure to comply with the provisions of this section is an offence and is punishable with imprisonment for a period not exceeding 15 years or to a fine not exceeding R10 000 000

<sup>329</sup> Section 30 of FICA

<sup>330</sup> Ibid



service are in stark contrast between the Islamic banking and that of the conventional banking institutions.

South Africa implements a form of secularism that does not depend on an inflexible disassociation between religion and state. Instead, it encourages collaboration between the two. In the next chapter I will explore ways in which a secular state can respect the South African minority Muslim community's freedom of religion, acceptance of Islamic contracts and difficulties that may arise. The next chapter emphasizes on the various measures taken by regulators to develop and promote the Islamic Industry in South Africa.

## CHAPTER FIVE: THE RECOGNITION, ACCOMMODATION AND INCORPORATION OF ISLAMIC LAW IN SOUTH AFRICA

### 5.1 Introduction

South Africa has a culturally diverse society, in which different religious and cultural groups, such as Muslims and Hindus live according to their own tradition.<sup>331</sup> The discussion of customary law is noteworthy in this chapter because it helps the reader to become familiar with the recognition of religious customs such as Islam into the South African legal system. This chapter presents the recognition of customary law in South Africa and the difficulties and challenges faced by the judiciary when applying customary law. The importance and adoption of customary law in South Africa has been made clear by the Constitutional Court Case law. In light of this, the purpose of the chapter is to assess the use of precedents and doctrines for the interpretation of international law.

The recognition of the cultural diversity of South Africa provided for the enactment of legislation recognising systems based on religion and culture. This legislative recognition must be consistent with the Bill of Rights and other provisions of the Constitution. The chapter places emphasis on the legal requirement of the right to freedom of religion and Islamic law in South Africa. This right is enshrined in the *Constitution* in terms of Section 9, the equality clause. This section prohibits unfair discrimination on various grounds including religion. The framework for the discussion in this chapter is South Africa's widely acclaimed *Constitution*, the centrepiece of which is a fully justiciable Bill of Rights protecting, *inter alia*, the freedom to pursue cultures and religions of choice. The leading cases of *Christian Education, South Africa v Minister of Education*<sup>332</sup> and *Prince V Cape Law Society*<sup>333</sup> are

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<sup>331</sup>Rautenbach C “Deep Legal Pluralism in South Africa: Judicial accommodation of Non-State law” No 60 (2010)

<sup>332</sup> 2000 (4) SA 757 (CC); 2000 (10) BCLR 1051 (CC)

discussed in this chapter to illustrate that the rights in the Bill of Rights are subject to the limitations contained or referred to in section 36, or elsewhere in the Bill. Finally, what is regarded as a relevant provision of the *Bill of Rights*, which impacts on the law of contract and which will be considered in the section that follows is, to what degree foreign law influences the South African courts?

Section 39 of the *Constitution* provides that, when interpreting the *Bill of Rights*, courts may consider international law and foreign law. This is significant in finding answers to the focal point of this thesis. In some important case<sup>334</sup> the Constitutional Court relied heavily on foreign law when interpreting the Bill of rights and developing the common law whilst some judges fear that when receiving foreign law, such law may come from different social background and environment.

The current legal framework for dispute resolution in the Islamic banking and finance industry in South Africa may not adequately serve the purpose for which the financial institutions were set up. This chapter considers some of the challenges associated with Islamic products and services, in relation to their impact on recognition, accommodation and conflict faced by the South African judiciary. In South Africa, there have been significant developments with Islamic financial services since the tax proposals were announced in the year 2010. The sector has been boosted by the government's efforts to accommodate its products and services in financial regulation, with a view to South Africa becoming the Islamic finance hub for sub-Saharan Africa.<sup>335</sup>The introduction of legislation dealing with Islamic finance has been inserted in the

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<sup>333</sup> 2002 (2) SA 794; 2002 (3) BCLR 231

<sup>334</sup> *Qozeleni v Minister of Law and Order and Another* 1994 (2) SALR 340 at 348; *Park-Ross and Another v The Director, Office of Serious Economic Offences* 1995 (2) BCLR 198 (C) 208-209; See especially, the remarks of Kriegler RJ in *Bernstein v Bester* 1996 4 BCLR 449 (CC); 1996 (2) SA (CC) Para 133

<sup>335</sup> *Ibid*

Taxation Laws Amendment Act, 2010. The amendments to the Income Tax Act will be examined in this chapter to illustrate the accommodation of tax neutrality between Islamic and conventional finance in South Africa.

The judgement in *Lodhi 5 Properties Investments CC v FirstRand Bank Limited*<sup>336</sup> (hereinafter referred to as the Lodhi case) raises important issues regarding the enforceability of Islamic finance law and therefore merits discussion in this chapter, in the context of the continuing growth and expansion of Islamic banking and finance law in South Africa.

## 5.2 The Recognition of Customary Law in South Africa

The South African legal system is a hybrid system based on Roman Dutch and English common law principles.<sup>337</sup> The third system which is recognised is customary law. Customary law refers to “customs and usages traditionally observed among the indigenous peoples of South Africa and which form part of the culture of those peoples.”<sup>338</sup> Customary law is the written and unwritten rules which have developed from the customs and traditions of communities which are recognised by the *Constitution*.<sup>339</sup> For customs and traditions to become law, they must be, known to the community, followed by the community and enforceable.<sup>340</sup> Therefore, customary law has been given recognition by the *Constitution*<sup>341</sup> but because it is based on unwritten customs, it presents some challenges. It does not qualify as law unless it is

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<sup>336</sup> [2015] 3 All SA 32 (SCA)

<sup>337</sup> Rautenbach C, Van Rensburg FJ & Peinaar G *Culture in Constitutional Adjudication* Volume 6 No 1 (2003)

<sup>338</sup> Section 1, Recognition of Customary Marriages Act, 120 of 1998.

<sup>339</sup> African Charter on human and peoples right chapter 2 <http://www.justice.gov.za/policy/african%20charter/afr-charter02.html> (accessed 25 May 2015)

<sup>340</sup> Section 27 of the Constitution

<sup>341</sup> Sec 211 of the Constitution

proven that it has existed for a long time, observed by the community and is not contrary to the *Constitution*.<sup>342</sup>The *Constitution* also places a duty on South African courts to apply customary law. This duty is reflected in section 211(3) 'which provides "that the institution, status and role of traditional leadership, according to customary law, are recognised, subject to the *Constitution*.' A traditional authority that observes a system of customary law may function subject to any applicable legislation and customs which include amendments to, or repeal of, that legislation or those customs.<sup>343</sup> The court must apply customary law when the law is applicable, subject to the *Constitution* and any legislation that specifically deals with customary law.<sup>344</sup>

Section 211 (3) still leaves the courts with a discretion on whether to apply customary law or not.<sup>345</sup> The importance and adoption of customary law in South Africa has been made clear by the Constitutional Court in a number of cases. For instance, in *Alexkor v Richtersveld Community* <sup>346</sup> the Constitutional Court emphasized that customary law is deemed to be uniform with the common law. Customary law is an essential part of law with an unfettered custom and is recognized within the legal system. In *Gumede v The President of the RSA*<sup>347</sup>the court emphasised that the special characteristics, that enables the customary law to be successful, is that, the law must be in agreement with the *Constitution*, its values and international human rights. This ensures the development of customary law.

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<sup>342</sup> William C & Rammutla T *The official version of customary law vis-à-vis the living Hananwa family law* (2013)

<sup>343</sup> Chapter 12 of the Constitution

<sup>344</sup> Sec 211 (1) of the Constitution

<sup>345</sup>Sec 211 (3) The courts must apply customary law when that law is applicable, subject to the Constitution and any legislation that specifically deals with customary law. South African law commission [http://www.justice.gov.za/salrc/ipapers/ip04\\_prj\\_90\\_1996.pdf](http://www.justice.gov.za/salrc/ipapers/ip04_prj_90_1996.pdf) (accessed 25 May 2015)

<sup>346</sup> 2003 (12) BCLR 1301 (CC)

<sup>347</sup> 2009 3 SA 152

Another case that brought customary law to the fore is *Bhe v Magistrate Khayelitsha*.<sup>348</sup> This case stands for the position that customary law must be accommodated in South Africa on condition that customary law is not in conflict with the *Constitution*. The difficulties of developing customary law were noted by the Judge Langa DCJ who pointed out that ‘The question whether the court was in a position to develop that rule in a manner which would ‘promote the spirit, purport and objects of the Bill of Rights’ evoked considerable discussion during an argument. In order to do so, the court would first have to determine the true content of customary law as it is today and to give effect to it in its order. There is, however, insufficient evidence and material to enable the court to do this. The difficulty lies not so much in the acceptance of the notion of ‘living’ customary law, as distinct from official customary law, but in determining its content and testing it, as the court should, against the provisions of the bill of rights.’<sup>349</sup>

This has created a new dimension for customary law. However, there are fundamental differences between the common and customary law of South Africa which may hamper efforts to harmonise both these systems.<sup>350</sup> These differences include:

(a) The legal range of customary law is narrower than that of the common law;<sup>351</sup>

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<sup>348</sup> 2005 1 SA 580 (CC)

<sup>349</sup> Judge Langa DCJ comment in *Bhe v Magistrate Khayelitsha* 2005 1 SA 580 (CC) Para 109.

<sup>350</sup> Rautenbach C “South African Common and Customary Law of Intestate Succession: A Question of Harmonisation, Integration or Abolition” (2008) 12 electronic journal of comparative law <http://www.ejcl.org> (accessed 10 May 2017)

<sup>351</sup> Ibid

(b) Customary law is based on the ethos of reconciliation and solidarity, rather than vindication and individuality, which are salient features of the common law;<sup>352</sup>

(c) A unified system of customary law does not exist, whilst the common law (although large uncodified) consists of unified legal rules; and <sup>353</sup>

(d) Customary law is “living” law which depends for the most part on social practices, whilst the common law can be found in written authorities (old authorities, statutes, judicial decisions and custom).<sup>354</sup>

In taking these variations into consideration, one should guard against the temptation to simply use the common law take over certain areas of customary law. If harmonisation, integration or unification is way to go, there should be agreement and consistency even if we have to sacrifice our common law heritage in order to develop a new system.<sup>355</sup> Beck, Demirguc-Kunt, and Levine argued that one of the important factors, which could explain the development of the financial sector, was the legal system and the adaptability of laws to evolve following the emergence of new circumstances.<sup>356</sup> South African judiciaries have to take heed of this when legislating in areas of Islamic law such as *Takaful*.

The challenge faced in South Africa, is that its society constitutes off various traditional and cultural classifications. The application of the Bill of Rights against religious laws leads to difficulties when attempting to satisfy the

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<sup>352</sup> Ibid

<sup>353</sup> Ibid

<sup>354</sup> Ibid

<sup>355</sup> 2003 12 BCLR 1301 (CC) para. 51. See also, Pharmaceutical Manufacturers Association of SA: In re Ex Parte President of the Republic of South Africa 2000 2 SA 674 (CC); 2000 3 BCLR 241 (CC) para. 44; Mabuza v Mbatha 2003 4 SA 218 (C); 2003 7 BCLR 743 (C) para. 32; Bhe v Magistrate, Khayelitsha [43]

<sup>356</sup> Beck T A Demirguc-kunt A. Levine R Law, endowments and finance Journal of financial economics 70 (2004)

demands of both parties in a dispute. On the one hand, zealous members of religious and traditional communities are going to request full and unaltered acceptance and acknowledgement of their customary or religious beliefs, and on the other hand, the government is obligated by law, to ensure the constitutional protection of the rights of those who advocate religions or traditions.<sup>357</sup>

A country like South Africa, which is both religious and culturally diverse , can only thrive where all religions, cultures and other systems of belief are awarded an equal measure of protection and recognition by all organs of state, in particular the judiciary. The next chapter will consider recognition of freedom of religion and the difficulties experienced by South African judiciary.

### **5.3 Freedom of Religion and Islamic law in South Africa**

The aim of this chapter is not to discuss the content given to freedom of religion in South African law, but to comment on the readiness of the Constitutional Court to engage in foreign law in the context of religion. In order to do so, it is imperative to refer to the most important constitutional provisions dealing with religion.

The Republic of South Africa is one sovereign, democratic state founded on the values of democracy, freedom and human dignity.<sup>358</sup> The Constitution recognizes the right of freedom of religion.<sup>359</sup> Section 15 of the Constitution provides that;

1. *‘Everyone has a right to freedom of conscience, religion, thought and belief and opinion.’*

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<sup>357</sup> Rautenbach C, Van Rensburg F & Peinaar G *Culture in Constitutional Adjudication* Volume 6 No 1 (2003)

<sup>358</sup> Chapter 1 founding provisions of The Constitution of South Africa

<sup>359</sup> Act 108 of 1996



2. *Religious observances may be conducted at state or state aided institutions provided that;*

- a) *Those observances follow rules made by the appropriate public authorities;*
- b) *They are conducted on an equitable basis and*
- c) *Attendance at them is free and voluntary.*

3. *This section does not prevent legislation recognising*

1.1 *marriages concluded under any tradition, or a system of religious, personal or family law or*

1.2 *systems of personal and family law under any tradition or adhered to by persons professing a particular religion.'*

The provision of Section 15 (1) of the Constitution has two parts to it. The first part provides for the freedom to practice religion without interference from the state and the right to religious equality. This is an indispensable requirement according to the Constitution. However, religious rights are not unqualified and are restricted in terms of the law of general application.<sup>360</sup>

The relationship between these two provisions has been explained by Justice Ngcobo in *Prince V President, Cape Law Society* 'This Court has on two occasions considered the contents of the right to freedom of religion. On each occasion, it has accepted that the right to freedom of religion at least comprehends: (a) the right to entertain the religious beliefs that one chooses to entertain; (b) the right to announce one's religious beliefs publicly and without fear of reprisal; and (c) the right to manifest such beliefs by worship and practice, teaching and dissemination. Implicit in the right to freedom of religion is the "absence of coercion or restraint." Thus 'freedom of religion

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<sup>360</sup> Section 36 (1) The rights in the Bill of Rights may be limited only in terms of a law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom, taking into account all relevant factors, including—

- (a) The nature of the right
- (b) The importance of the purpose of the limitation
- (c) The nature and extent of the limitation
- (d) The relation between the limitation and its purpose
- (e) Less restrictive means to achieve the purpose

may be impaired by measures that force people to act or refrain from acting in a manner contrary to their religious beliefs.’ Multicultural secular democracies face a challenge in effectively and meaningfully guaranteeing the right to religion and culture.

In the landmark case of *Prince V South Africa*<sup>361</sup> the South African courts found that while the legislations in question did limit Mr Prince's constitutional rights, specifically the right to freedom of religion, these limitations were justifiable under Constitution. Section 15 (3) clearly states that the recognition of the right must be consistent with the Constitution. Religious groups cannot claim an automatic right to be exempt by their beliefs from the laws of the land. At the same time, the state should attempt to avoid the situation in which religious groups carry the burden of choosing between being true to their religion and being respectful the law. The case of *Christian Education South Africa v Minister of Education*<sup>362</sup> is worthy of mention. In this case, the court emphasised the fundamental importance of the right to express one’s religion in a pluralistic, multi-cultural society. This case dealt with the application to declare section 10 of the Schools Act<sup>363</sup> unconstitutional. The legal grounds for the application were that corporal punishment is against the religious beliefs of the appellant.<sup>364</sup> The Court held that corporal punishment violated the right to human dignity in section 10 and the right to be protected against punishment that is cruel, inhumane and degrading in section 12 of the *Constitution*.<sup>365</sup> Judge Sachs recognized the centrality of religion and stated that ‘*There can be no doubt that the right to freedom of religion, belief and opinion in the open and democratic society contemplated by the Constitution*

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<sup>361</sup> 2004) AHRLR 105 (ACHPR 2004).

<sup>362</sup> 2000 (10) BCLR 1051.

<sup>363</sup> Act 84 of 1996

<sup>364</sup> *Christian Education South Africa v Minister of Education* 2000 (10) BCLR 1051 Para 1

<sup>365</sup> *Christian Education South Africa v Minister of Education* 2000 (10) BCLR 1051 Para 49

is important. *The right to believe or not to believe, and to act or not to act according to his/her beliefs or non-beliefs, is one of the key ingredients of any person's dignity. Yet freedom of religion goes beyond protecting the inviolability of the individual conscience. For many believers, their relationship with God or creation is central to all their activities. It concerns their capacity to relate in an intensely meaningful fashion to their sense of themselves, their community and their universe. For millions in all walks of life, religion provides support and nurture and a framework for individual and social stability and growth. Religious belief has the capacity to awake concepts of self-worth and human dignity which forms the cornerstone of human rights. It affects the believer's view of society and founds the distinction between right and wrong. It expresses itself in the affirmation and continuity of powerful traditions that frequently have an ancient character transcending historical epochs and national boundaries.*<sup>366</sup>This case raised perplexing inquiries and attached importance and value to considerations of faith.

Previously, in South Africa, the judiciary has not been willing to accommodate religious freedoms to many individuals especially individuals belonging to the Islamic faith. However, the judgement in the 'watershed' case of *Hassam v Jacobs NO and Others*<sup>367</sup> was well received by the Muslim community and created a step towards entrenching constitutional rights for Muslims in South Africa.<sup>368</sup> The applicant was married to Mr Hassam (the deceased) in accordance with Islamic rites. The deceased was married a second wife, Mrs Mariam Hassam, also according to Islamic rites. The deceased died intestate in August 2001. His death certificate shows that he was never married. The

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<sup>366</sup>*Christian Education South Africa v Minister of Education* 2000 (10) BCLR 1051 Paragraph 36

<sup>367</sup> 2009 (11) BCLR 1148 (CC) ; 2009 (5) SA 572 (CC) (15 July 2009)

<sup>368</sup> Fayker HA "South African Engagement with Muslim Personal Law": The Women's Legal Centre, Cape Town and Women in Muslim Marriages  
[http://agi.ac.za/sites/agi.ac.za/files/fa\\_15\\_case\\_study\\_hoodah\\_abrahams-fayker.pdf](http://agi.ac.za/sites/agi.ac.za/files/fa_15_case_study_hoodah_abrahams-fayker.pdf)  
(accessed 26 September 2017)

first respondent refused to regard the applicant as a spouse for the purposes of the Intestate Succession Act 81 of 1987. The executor questioned the validity of the applicant's marriage to the deceased. The Constitutional Court held that section 1 of the Intestate Succession Act <sup>369</sup>unjustifiably infringed s 9(3) of the *Constitution*. The word 'spouse' in the Intestate Succession Act excluded widows to polygamous Muslim marriages, which denied this group the protection intended for vulnerable woman in society.<sup>370</sup>The Constitutional Court held that preventing the applicant from inheriting, unfairly discriminated the applicant on the grounds of religion, marital status and gender. The court found this was inconsistent with section 9 of the *Constitution*. Accordingly, it was held that Muslim women involved in polygamous marriages could inherit from their deceased husband's estate.<sup>371</sup>The court also held that in assessing the constitutional validity of the impugned legislative provisions, in this case, regard must also be had to the diversity of the South African society which provides a blue print for our constitutional order and influences the interpretation of the *Constitution*, and in turn shapes the ordinary law.<sup>372</sup> The court, however, emphasised that the judgment did not purport to incorporate any aspect of *Shari'ah* law into South African law.<sup>373</sup>The significance of this case is that the Promotion of Equality and Prevention of Unfair Discrimination Act affirm the right of people to be who they are without being forced to subordinate themselves to the cultural and religious norms of others and for communities to enjoy the "right to be different"<sup>374</sup> South Africa therefore

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<sup>369</sup> Act 81 of 1987

<sup>370</sup> Section 1 of the Intestate Succession Act 81 of 1987

<sup>371</sup> *Hassam v Jacobs NO and Others* 2009 (11) BCLR 1148 Para 57 (3)

<sup>372</sup> *Hassam v Jacobs NO and Others* 2009 (11) BCLR 1148 Para 26

<sup>373</sup> *Hassam v Jacobs NO and Others* 2009 (11) BCLR 1148 Paragraph 16

<sup>374</sup> Muna B and Ndulo: "Legal and Humanitarian Perspectives on Equality, State Neutrality and Pluralism: Freedom of Religion in the South African Context"  
[https://conference.archons.org/presentations//asset\\_publisher/cplG8Kxvongt/content/muna-b-ndulo-legal-and-humanitarian-perspectives-on-equality-state-neutrality-and-pluralism-](https://conference.archons.org/presentations//asset_publisher/cplG8Kxvongt/content/muna-b-ndulo-legal-and-humanitarian-perspectives-on-equality-state-neutrality-and-pluralism-)

enables private and public accommodation of religious beliefs and practices. However, South Africa does not accommodate religious diversity without limitations.

#### 5.4 The Accommodation of Islamic Contracts in South Africa

Throughout history, Muslims were traders and tried to abide by interest-free forms of finance which are permissible in Islamic finance. Historically, Islamic contracts were not recognised in South Africa but this was rectified by the implementation of the Bill of Rights in the *Constitution*. Section 21 of the *Constitution* provides that 'every person has a right to choose their trade, occupation or profession freely.'<sup>375</sup> 'The practice of trade, occupation or profession is regulated by the law.'<sup>376</sup> Therefore parties are free to agree, either expressly or tacitly, on a specific legal system to govern their contract.<sup>377</sup>

The case of *Carrim v Omar*<sup>378</sup> is a riveting case because it displays casually, how the resilient principles of the ordinary commercial law can adapt to the *Mudaraba* contract.<sup>379</sup> In the *Carrim v Omar* case,<sup>380</sup> the plaintiff invested money in an Islamic bank. This money was withdrawn from Volkskas

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[freedom-of-religion-in-the-south-african-context-?inheritRedirect=false](#) (accessed 27 September 2017)

<sup>375</sup> Section 21 of the Constitution of South Africa 1996

<sup>376</sup> Ibid

<sup>377</sup> *Kleinhans v Parmalat S.A. (Pty) Ltd (P151/01) [2002] ZALC 57 (27 June 2002)* Consistent with the common law principle of party autonomy, parties to international contracts are free to agree, expressly or tacitly, on the specific legal system to govern the contract. In the absence of such agreement it is open to the Court to assign the proper law of the contract and jurisdiction.

<sup>378</sup> 2001 (4) SA 691 (W)

<sup>379</sup> Forsyth C and Max Du Plessis M "Surety, Guarantee and Islamic Banking" (2004) Volume 119 at 671 *South African Law Journal*

<sup>380</sup> 2001 (4) SA 691 (W)

Bank<sup>381</sup> on the account of interest that was earned from the investment thereof. An Islamic (*Mudaraba*) contract was accepted by the Islamic bank and the plaintiff. Both parties agreed to share in profit and losses. The Volkskas bank was liquidated and the plaintiff thereafter claimed her investment from the defendant on the grounds that the defendant assumed liability as a co-principle debtor. The defendant argued that the contract was void because it was an oral contract of suretyship, therefore, it did not comply with the formalities of the Law of Evidence Amendment Act.<sup>382</sup> Section 11 of Law of Evidence Amendment Act provides that;

*11 (1) Any court may take judicial notice of the law of a foreign state and of indigenous law in so far as such law can be ascertained readily and with sufficient certainty: Provided that indigenous law shall not be opposed to the principles of public policy and natural justice: Provided further that it shall not be lawful for any court to declare that the custom of lobola or bogadi or other similar custom is repugnant to such principles.*

*(2) The provisions of subsection (1) shall not preclude any party from adducing evidence of the substance of a legal rule contemplated in that subsection which is in issue in the proceedings concerned.*

In the appeal case *Carrim v Omar* (supra)<sup>383</sup> the decision confirmed that the contractual (*Murabaha*) principle of ‘*providing for eventualities relating to both profits and losses*’ implying thereby that losses resulting from negligence would be upheld in common law.”<sup>384</sup> The Honourable Judge Stegmann observed ‘that the legal issue to be decided in the appeal was whether the defendant validly undertook the enforceable primary obligations of an indemnifier or guarantor or

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<sup>381</sup> Volkskas Beperk (Peoples' Bank) was a South African bank founded in 1934 as a cooperative loan bank

<sup>382</sup> Act 45 of 1988

<sup>383</sup> 2001 (4) SA 691 (W)

<sup>384</sup> 2001 (4) SA 691 (W)

whether the defendant merely purported to undertake the accessory obligations of a surety for the indebtedness of the principal debtor (the Islamic Bank Ltd) to the plaintiff.<sup>385</sup> The Appeal Court further held that the defendant undertook a primary obligation and not an accessory one which was dependant on a principal debt. <sup>386</sup>Therefore the Law of Evidence Amendment Act<sup>387</sup> did not apply and accordingly the appeal was dismissed. <sup>388</sup>

This case illustrates that in South Africa, the enforceability of Islamic contracts are recognised. The recognition was, however, made subject to the repugnancy clause in terms of the law of Evidence Amendment Act.<sup>389</sup> This was tested according to public policy and natural justice as stipulated in terms of section 11 of the Act. Courts do take judicial notice of customary law but this must be qualified by the fact that such law is “readily ascertainable and sufficiently certain.”<sup>390</sup> Therefore, notwithstanding that, the Constitution of South Africa allows for the freedom of religion and trade, this freedom is in many cases legitimately limited and is not absolute.

The use of foreign law by South African courts is expressed by the South African Constitution. Although South African courts are said to have used foreign law often, information concerning the specific numbers regarding the frequency of use, extent of use, and the influence that foreign law has had on

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<sup>385</sup> See Carrim V Omar (2001) 3 All SA71 (W) at paragraph 31

<sup>386</sup> Carrim v Omar [2001] 3 A11 SA 71 (W) at paragraphs 28-68

<sup>387</sup> Act 45 of 1998

<sup>388</sup> Carrim v Omar [2001] 3 A11 SA 71 (W) at paragraphs 28-68

<sup>389</sup> Ibid

<sup>390</sup> Van Niekerk GJ “The Interaction of indigenous law in South Africa: A Historical and Comparativeperspective”.[http://uir.unisa.ac.za/bitstream/handle/10500/17738/thesis\\_vanniekerk\\_gj.pdf?sequence=1](http://uir.unisa.ac.za/bitstream/handle/10500/17738/thesis_vanniekerk_gj.pdf?sequence=1) (accessed 27 September 2017)

South African courts has been difficult to locate. In the next section, a few comments are made about some of the methodological tools available for interpreting and identifying rules of international law. I will provide, in the next section, a brief overview of the aspects of the judgment concerning the incorporation of foreign law.

### **5.5 The Difficulty in Incorporating Foreign Law in South Africa**

This chapter briefly describes the mandate on the use of foreign law (comparative interpretation) contained in the South African *Constitution*, the reasons foreign law is used and the difficulties experience by the *Constitution*. *The Constitution* provides 'that when interpreting the Bill of Rights, a court, tribunal or forum must;

- 1) promote the values that underlie an open and democratic society based on human dignity, equality and freedom;
- 2) must consider international law; and,
- 3) may consider foreign law'

The Republic of South Africa has a dual legal system and there are instances where internal conflicts between laws occur. For example, between Islamic law and South African law. As mentioned above, parties in South Africa are free to agree, either expressly or tacitly, on a specific legal system to govern their contract. Irrespective of the agreement, parties must also be able to enforce their rights in court. But the question whether the parties enjoy their own choice of legal system is highly debatable.

Every country has similarities and differences in law and the balancing of the interests of the law remains a challenge. It is complicated to ascertain when the common law and when the customary law will be pertinent<sup>391</sup> Parties often find themselves in overlapping and divergent circumstances emanating from conflicting legal systems. The courts have to ascertain which law is applicable

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<sup>391</sup> Rautenbach C "Deep Legal Pluralism in South Africa: Judicial accommodation of non-state law (2010) Volume 24 Issue 60 at 144 *The Journal of Legal Pluralism and Unofficial Law*



to a certain set of facts through the implementation of the choice of law rules.<sup>392</sup>

In a manner conforming to the South African private international law, matters of procedure are presided over by the domestic law of the country, in which the relevant proceedings are instituted (*lex fori*)<sup>393</sup> and matters of substance are governed by the applicable law which applies to the transaction (*lex causae*).<sup>394</sup> When there is a conflict of laws and a debate about which legal system is applicable, it is commonly agreed that the *lex fori* is the preferred law.<sup>395</sup> Forsyth criticises the *lex fori* for being fickle due to the fact that it is determined *ex post facto* when the plaintiff decides to sue.<sup>396</sup>

In the absence of an express or tacit election of the proper law of an agreement, the correct approach to follow is to disregard the parties' intentions pertaining to such an election and take into consideration the factual nexus between the *naturalia* of the agreement and the legal systems that could potentially be applied to the agreement. Furthermore, there is no standard or norm that is provided to the courts to guide the court on how to adopt an applicable foreign law for application. Neither is there a standard to assist the courts in establishing to what extent foreign laws may be used in

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<sup>392</sup> Ibid

<sup>393</sup> Wakefield R: "Getting the Deal Through: Enforcement of Foreign Judgments" 2012 at 108

<sup>394</sup> Society of Lloyds v Price; Society of Lloyd's v Lee' (327/05) [2006] ZASCA 88; [2006] SCA 87 (RSA) (1 June 2006) paragraph 10

<sup>395</sup> Terblanche P "Lex fori or lex loci delicti?" The problem of choice of law in international delicts. November 1997) Volume. 30, No. 3 at 243-263 *The Comparative and International Law Journal of Southern Africa*

<sup>396</sup> Terblanche P "Lex fori or lex loci delicti?" The problem of choice of law in international delicts. November 1997) Volume. 30, No. 3 at 243-263 *The Comparative and International Law Journal of Southern Africa*

deliberations and decisions.<sup>397</sup> With such an unlimited prerogative, the adoption of foreign law could be problematic.<sup>398</sup>

Courts and litigants need a clear and explicit choice of law rules to indicate when the common or customary law will be applicable to the facts of a particular case. As an example, in the recent case of *Representatives of Lloyds v Classic Sailing Adventures (Pty) Ltd*,<sup>399</sup> the Supreme Court Appeal held that parties cannot exclude mandatory provisions of the South African statute by choice of other legal systems.<sup>400</sup> The judgment raises important issues regarding the enforceability of Islamic finance law and therefore merits discussion in the context of the continuing growth and expansion of Islamic banking and finance law in South Africa. The parties to a marine insurance policy agreed that the English law is the applicable law to govern the contract and that South African courts would have jurisdiction. Lloyds relied on sections of the English Act in support of its special defences which was inconsistent and in conflict with section 53 and 54 of the South African Short-term Insurance Act.

The general rule is that when there is a conflict of laws, the proper law of contract is the appropriate law. In South African private international law, there are no comprehensible jurisdictions regarding, the feasible restrictions on the independence and self-determination of contracts to settle on an applicable legal system.<sup>401</sup> The viewpoint of many scholars is that statutes are

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<sup>397</sup> Goitom H “The Impact of Foreign Law on Domestic Judgments: South Africa” <https://www.loc.gov/law/help/domestic-judgment/southafrica.php> (accessed 13 July 2017) 2010

<sup>398</sup> Goitom H “The Impact of Foreign Law on Domestic Judgments: South Africa” <https://www.loc.gov/law/help/domestic-judgment/southafrica.php> (accessed 13 July 2017) 2010

<sup>399</sup> 2010 (5) SA 90 (SCA)

<sup>400</sup> *Representatives of Lloyds v Classic Sailing Adventures (Pty) Ltd* 2010 (5) SA 90 (SCA) Paragraph 21

<sup>401</sup> Act 45 of 1988

the favourable law and party autonomy will not triumph over the authoritarian provisions of a statute typically where the action relates to the provisions of a statute.<sup>402</sup> Contractual parties ought to have a choice to agree on a system of law to govern their contract which does not include the application of the provisions of that statute.

In South Africa, the application of foreign law is that it is very lenient and not strictly enforceable like domestic law. To apply one legal system against another may result in unsatisfactory results. Litigants do not have anywhere near the same amount of freedom to decide procedural matters. South African statutes outweigh any conflicting provisions in international treaties or international law not explicitly incorporated into South African statutes.<sup>403</sup> The decisions of foreign courts only have a persuasive effect and only become binding when adopted with approval by a national court. The South African courts, first examine the imbalance between the principle of foreign laws and South African laws, before contemplating the adoption of a foreign decision.<sup>404</sup> In *S v Mhlungu* and others,<sup>405</sup> the Honorable Mohamed J observed that the literal interpretation of the *Constitution* involves difficulties and leads to unjust and absurd results.<sup>406</sup> He further contends that, it would deny to a substantial group of people the equal protection of fundamental rights guaranteed by Chapter 3.<sup>407</sup>

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<sup>402</sup> Malan D Contracting with Foreigners A choice of South African law as the proper law of the agreement is enough evidence of an intention to consent to South African jurisdiction <https://www.bregmans.co.za/contracting-with-foreigners/> (accessed 24 January 2019)

<sup>403</sup> Dr H Hahn and Luterek J *et al* "SA patents litigation," published in Patent Litigation Jurisdictional Comparisons, European Lawyer reference series, Ed. Thierry Calame and Massimo Sterpi, 2006

<sup>404</sup> Ibid

<sup>405</sup> 1995(7) BCLR 793(CC)

<sup>406</sup> S V Mhlungu and others 1995(7) BCLR 793(CC) [3]

<sup>407</sup> S V Mhlungu and others 1995(7) BCLR 793(CC) [33]

In conflict of laws, the Law of Evidence Amendment Act<sup>408</sup> is a crucial element to deal with a customary law which is the rule of recognition and not the choice of law. The parties cannot choose a legal system to govern the contract if such system has no nexus to the contracting parties even though such legal system has specialised rulings to govern the contract.<sup>409</sup>

In the words of Ackermann<sup>410</sup>: One may be seeking information, guidance, stimulation, clarification, or even enlightenment, but never authority binding on one's own decision. One is doing no more than keeping the judicial mind open to new ideas, problems, arguments and solutions. And also: The fact that in a particular case, the caution which should accompany the use of foreign constitutional law<sup>411</sup> is not explicitly repeated, does not warrant the inference that due care was not taken.<sup>412</sup>

Islamic law regards the charging of interest on loans as expressive and exploitative. If the financial system were based on compliance to the classical position and the prohibition against levying interest on loans, this would raise a simple question: how would lenders be able to yield positive returns from the capital amounts that they advanced, without contravening Islamic law. Hence products such as *Takaful* were designed and seen as an alternative to conventional Insurance. Due to its strong foundation of Islamic principles which are based on the concept of brotherhood and solidarity which eliminates non-*Shariah* compliance such as interest. The objective of this paper is to explore the accommodation of *Takaful* in the South African legal system, the next chapter highlights how South Africa has attempted to

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<sup>408</sup> Act 45 of 1988

<sup>409</sup> *Fose v Minister of Safety and Security* 1997 (7) BCLR 851; 1997 (3) SA 786 (5 June 1997)

<sup>410</sup> Ackermann 2006 *SALJ* 507

<sup>411</sup> Although Ackermann gives this explanation in the context of "comparative constitutional law," the same reasoning applies to comparative case law

<sup>412</sup> Ackermann 2006 *SALJ* 506

accommodate Islamic finance principles including *Takaful* into their legal regime.

## **5.6 The Accommodation of Islamic Finance into the Income Tax Act of South Africa**

In 2010, the South African government communicated their interest in the development of Islamic finance and shared their vision in promoting South Africa as an Islamic finance hub in Africa. The Minister of Finance, Pravin Gordhan stated that 'The development of Islamic finance in South Africa is critical to the expansion of National Treasury's strategy to position South Africa as a gateway into Africa.'<sup>413</sup>

Islamic insurance known as *Takaful* is specifically excluded since the proposed changes to the Income tax legislation does not refer to this type of product. The Income Tax Act<sup>414</sup> is important for the role it plays in the taxation of policies and the recognition of Islamic finance in South Africa.<sup>415</sup> The South African banking industry has made significant developments in the implementation of Islamic products into the industry.<sup>416</sup> The introduction of section 24JA of the Income Tax Act set out the proposed legislation for Islamic financial products. This proposal was proclaimed in the draft Taxation Laws Amendment Law 2010. The explanatory memorandum of the Taxation law Amendment Law 2010 explained Islamic finance as follows:

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<sup>413</sup> The Islamic finance gateway into Africa <http://ww2.oldmutual.co.za/old-mutual-investment-group/insights/magazines/tomorrow-2015/sa-the-islamic-finance-gateway-into-africa> (accessed 29 September 2017)

<sup>414</sup> Act 58 of 1962

<sup>415</sup> Salah O and Rautenbach C Islamic finance: a corollary to legal pluralism or legal diversity in South Africa and the Netherlands? *The Comparative and International Law Journal of Southern Africa* Vol. 48, No. 3 (2015), pp. 488-515

<sup>416</sup> Brinker E "Islamic finance *et al* South Africa development on taxes" [http://www.legal500.com/firms/11730-dla-cliffe-dekker-hofmeyr/press\\_releases/28575](http://www.legal500.com/firms/11730-dla-cliffe-dekker-hofmeyr/press_releases/28575) (accessed 29 January 2015)

Islamic finance is based on certain principles that impact transaction form which includes

- a) The prohibition of interest (Riba).
- b) The prohibition of uncertainty (Gharar).
- c) Risk sharing (the removal of asymmetrical information from contracts and encouragement of full disclosure).
- d) Materiality (financial transactions must be linked to a real economic transaction).<sup>417</sup>

Therefore, in relation to this bill, the Islamic products *Mudaraba*, *Murabaha*, *sukuk* and diminishing *Musharaka* were recognised. The year 2011, marked the rise of *Shari'ah* compliant products, locally and internationally, which was included in the Income Tax Act<sup>418</sup> such as the Islamic collective Investment scheme<sup>419</sup> and the provision of advisory services for the structuring and issuance of a debut government (sovereign) *sukuk*.<sup>420</sup>

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<sup>417</sup> Explanatory memorandum on the Taxation Law Amendment Bill 2010 <http://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2010-01%20%20Explanatory%20Memorandum%20Taxation%20Laws%20Amendment%20Bill%202010.pdf> (accessed 29 January 2015)

<sup>418</sup> Act 58 of 1962.

<sup>419</sup> Bank Negara Malaysia Guidelines on Investment in Shares, Interest-in-Shares and Collective Investment Schemes for Islamic Banks Islamic Collective scheme is defined as any arrangement made for the purpose, or having the effect of providing facilities for persons to participate in or receive profits or income arising from the acquisition, holding, management or disposal of securities, future contracts or any other property, or such sums paid out of such profits or income. In such schemes participants do not have day to day control over the management of the schemes assets. [http://www.bnm.gov.my/guidelines/01\\_banking/04\\_prudential\\_stds/14\\_Investment\\_in\\_Shares\\_IIS\\_and\\_CIS\\_2806.pdf](http://www.bnm.gov.my/guidelines/01_banking/04_prudential_stds/14_Investment_in_Shares_IIS_and_CIS_2806.pdf) (accessed 29 January 2015)

<sup>420</sup> A *Sukuk* is defined in the Income Tax Act as a *Shariah* financing agreement, whereby the government disposes of an interest in an asset to a trust (which the investors fund) and leases the asset back from the trust. Any consideration received for the use of that asset by the trust is distributed to the investors and per the Income Tax Act is deemed to be interest in the hands of the investors. At the end of the lease term, government repurchases the asset which serves as the repayment of the principal investment. <http://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2014-02%20%20Explanatory%20Memorandum%20on%20the%20TLA%20Bill%2013%20of%202014.pdf> (accessed 29 January 2015)

An essential requirement of Islamic finance is to discontinue interest (*Haraam* income). Islamic finance companies abide by the interest-free requirement by ensuring that, *Shari'ah*-compliant collective investment schemes are subject to agreements that avoid *Haraam* amounts from being distributed to unit holders. <sup>421</sup>These collective investment schemes, donate impermissible amounts which accrue from interest or dividends to charity.<sup>422</sup>

In reference to the Islamic financial product named *sukuk*. This definition excludes other entities from entering into *sukuk* arrangements. *Shariah* compliant financing is the starting point to a prospective source of inexpensive funding which will benefit the economy and the state. It is proposed that “public entities should be included in the Islamic finance arrangement”<sup>423</sup> and the definition and deeming provisions of a *sukuk* should be amended to also include other entities.”<sup>424</sup>

On the 16<sup>th</sup> January 2017 a ruling was made by the South African Revenue Services to determine the income tax consequences of an Islamic financing arrangement, known as a “*Mudaraba*” arrangement, for the parties.<sup>425</sup> The ruling made in connection with the proposed transaction is as follows:

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<sup>421</sup> Explanatory memorandum on the Taxation Law Amendment Bill 2010 <http://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2010-01%20-%20Explanatory%20Memorandum%20Taxation%20Laws%20Amendment%20Bill%202010.pdf> (accessed 29 January 2015)

<sup>422</sup> Ibid

<sup>423</sup> Explanatory memorandum on the taxation law Amendment Bill 2014 <http://www.sars.gov.za/AllDocs/LegalDoclib/ExplMemo/LAPD-LPrep-EM-2014-02%20-%20Explanatory%20Memorandum%20on%20the%20TLA%20Bill%2013%20of%202014.pdf> (accessed 29 January 2015)

<sup>424</sup> Ibid

<sup>425</sup> Jutas Tax Law review [https://juta.co.za/media/filestore/2017/03/JTLR\\_2017\\_1\\_28March2017FIN\\_0WfyeQO.pdf](https://juta.co.za/media/filestore/2017/03/JTLR_2017_1_28March2017FIN_0WfyeQO.pdf) (accessed 14 July 2017)

a) Section 24JA, insofar as it applies to a “sukuk” as defined, will not apply to the sukuk certificates to be issued by the Trust. <sup>426</sup>

b) The proceeds from the issue of the sukuk certificates will not form part of the Trust’s “gross income” as defined in section 1(1). <sup>427</sup>

c) The proceeds from the issue of the tier 2 certificates will not form part of the Applicant’s “gross income” as defined in section 1(1). <sup>428</sup>

d) Section 24JA (2) will apply to the Mudaraba agreement to be entered into between the Applicant and the Trust. Accordingly, the periodic distribution amounts received by or accruing in favor of the Trust will constitute “interest”, as defined in section 24J(1). <sup>429</sup>

South African legislators have attempted to complete their task of ensuring the accessibility of Islamic financial arrangements to other entities. The Tax law Amendment Act of 2010 recognized Islamic arrangements as an alternative to conventional products. They were further amended in 2011 wherein Sukuk was introduced. Further amendments are on the cards in 2017 that will impose donations tax on interest-free or low interest loans advanced to trusts.

### **5.7 The Conflict between Islamic Banking and South African Banking Law**

The South African Reserve Bank (hereinafter referred to as the Reserve Bank) is the central bank of South Africa<sup>430</sup> and receives its directive from the

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<sup>426</sup> Legal counsel - Islamic Financing Arrangement: South African Revenue Services <http://www.sars.gov.za/AllDocs/LegalDoclib/Rulings/LAPD-IntR-R-BPR-2017-01%20-%20BPR%20257%20Islamic%20financing%20arrangement.pdf> (accessed 14 July 2017).

<sup>427</sup> Ibid

<sup>428</sup> Ibid

<sup>429</sup> Ibid

<sup>430</sup> Sections 223 to 225 of the Constitution of the Republic of South Africa, 1996, the South African Reserve Bank Act, 1989 as amended and the regulations framed in terms of this Act,



Constitution.<sup>431</sup> The primary purpose of the Reserve Bank is to ‘achieve and maintain price stability in the interest of balanced and sustainable economic growth in South Africa.’<sup>432</sup>The Reserve Bank, with other institutions, also plays an essential part in the establishment of financial stability.<sup>433</sup> Financial stability is defined as a ‘sustained condition of stability in the financial system that ensures the efficient functioning of institutions and markets and low volatility in prices, interest rates and exchange rates.’<sup>434</sup>

The Reserve Bank can issue its own interest-bearing securities and buy, sell, discount, rediscount, grant loans or advances against these securities.<sup>435</sup>The Reserve Bank can also enter into repurchase agreements with any institution in relation to interest-bearing securities.<sup>436</sup> The Reserve Bank also enters into agreements with foreign institutions to borrow at such rate of interest any foreign currency which the bank may consider it expedient to acquire<sup>437</sup>The Reserve Bank also issues banking licences to banking institutions and monitors their financial activities in terms and regulations of either the Banks Act 94 of 1990<sup>438</sup>or the Mutual Banks Act of 124 1993.<sup>439</sup>South African

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provide the enabling framework for the Bank's operations. The Bank has a considerable degree of autonomy in the execution of its duties

<sup>431</sup>South African Reserve bank  
<https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/4987/SARB%20Commemorative%20publication.pdf>

<sup>432</sup> Ibid

<sup>433</sup> Ibid

<sup>434</sup> Financial stability  
<https://www.resbank.co.za/Financial%20Stability/Pages/FinancialStability-Home.aspx>  
(accessed 26 March 2015)

<sup>435</sup> Ibid

<sup>436</sup> Section 10 (l) of the South African Reserve Bank 1989

<sup>437</sup> Section 10 (r) The South African Reserve Bank 1989

<sup>438</sup> The purpose of the Banks Act is to provide for the regulation and supervision of the business of public companies which includes banks from taking deposits from the public

banking comprises of five large banks which are First National Bank,<sup>440</sup>ABSA,<sup>441</sup>Standard Bank<sup>442</sup>Nedbank<sup>443</sup> and Capitec Bank<sup>444</sup> which govern the banking transactions. The South African banks utilise money, interest or income earned on money and accepted by way of deposit, granting of loans and financing.<sup>445</sup> The insurers also need to comply with the requirements of the Banks Act 94 of 1990<sup>446</sup> and Mutual Banks Act 124 of 1993.The Financial Sector Regulations Act 9 of 2017, <sup>447</sup>also ensures that there are cooperation and collaboration between the financial sector regulators, the National Credit Regulator, the Financial Intelligence Centre and the South African Reserve Bank.<sup>448</sup>

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<sup>439</sup>The Mutual Banks Act provides for the regulation and supervision of the activities of juristic persons doing business as mutual banks Management of the South African Banking system <https://www.resbank.co.za/AboutUs/Functions/Pages/Management-of-the-South-African-money-and-banking-system.aspx> (accessed 1 September 2014)

<sup>440</sup> Ibid

<sup>441</sup> Ibid

<sup>442</sup>Having put down its roots in the Eastern Cape in 1862, Standard Bank is one of South Africa's oldest companies <http://www.standardbank.com/> ( accessed 25 May 2015)

<sup>443</sup> Nedbank group <http://www.nedbank.co.za/website/content/home/index.asp> (accessed 25 May 2015)

<sup>444</sup> Capitec <https://www.capitecbank.co.za/bankbetterlivebetter> (accessed 26 September 2017)

<sup>445</sup> The definition of "the business of a bank" substituted by section 1(h) of Act 19 of 2003

<sup>446</sup> The Banks Act 94 of 1990

<sup>447</sup> Financial Regulatory Act Signed into **law** in August **2017**, the **Financial Sector Regulation (FSR) Act** is effective from 1 April **2018**, and is a piece of **legislation** that will bring about a major transformation of the South African **financial** services **regulatory** and risk management framework, including the move to a Twin Peaks approach to **regulation**<http://www.treasury.gov.za/legislation/acts/2017/Act%209%20of%202017%20FinaSectorRegulation.pdf> (accessed 24 January 2019).

<sup>448</sup> Financial Sector Regulation Act 7 of 1997<http://www.polity.org.za/article/financial-sector-regulation-act-9-of-2017-english-sepedi-2017-08-24> (accessed 12 October 2017)

Islamic finance and insurance eliminates interest and conforms to the principle of fairness and sharing each other's burdens which will protect the less fortunate in South Africa. Therefore, there exists a conflict between Islamic law and South African law.<sup>449</sup>The law relating to interest in South Africa needs to be changed to accommodate interest-free and non-gambling transactions. South Africa's legislators must enhance economic development by encouraging risk-sharing instead of debt-financing. This will result in reducing poverty and inequality and South Africa will achieve a better socio-economic development which will bring greater justice to the society as a whole. The Islamic banking and financial system can, therefore, be served as an instrument to endorse economic growth and benefit humankind since it positively contributes to macroeconomic stability. Our South African community is in much need for profit sharing and equity participation to replace the undue enrichment caused by the charging and receiving of interest.

### **5.8 The Challenges Faced by the South African Judiciary when applying Islamic law**

Islamic finance, which is regulated and governed by *Shariah* law, is accepted in South Africa.<sup>450</sup> The application of Islamic finance, the enforceability and advancement in South Africa were raised for the first time, in the judgement in *Lodhi 5 Properties Investments v First Rand Bank Limited* (hereinafter referred to as the *Lodhi* case).<sup>451</sup> This is the first matter held at the Supreme Court of Appeal in South Africa, which dealt with the question whether the

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<sup>449</sup> C Rautenbach "Muslim personal law in South Africa 2004" volume 7 No 2

<sup>450</sup>Hesse M "Finance is based on Shared Prosperity"<http://www.iol.co.za/personal-finance/islamic-finance-is-based-on-shared-prosperity-9230978> personal Finance (accessed 12 July 2017)

<sup>451</sup> (2015) 3 ALL SA 32

prohibition against the charging of interest on a loan in terms of *Shariah* law may be a defence for a claim for *mora* interest of a loan agreement.<sup>452</sup>

The facts of the *Lodhi* case will be set out below. The parties approached the High court in three applications however; this dissertation will be limited to the courts approach, relating to the application of Islamic law of finance in South Africa. FirstRand Bank<sup>453</sup> offers to its customers, specialized services and products that are compliant with *Shariah* law. First Rand Bank entered into an interest free loan agreement as well as an “Agency and Administration Service Agreement” with Lodhi 5 Properties Investments. In accordance with the terms of the loan agreement, FirstRand Bank loaned a sum of R9.6 million to Lodhi 5 Properties investment for the purchase of properties. The loan amount would be payable in 120 instalments of R88 000.00.

According to the “agency agreement,”<sup>454</sup> FirstRand Bank acted as an agent and purchased the property on Lodhi 5’s behalf, in return for a fixed agency fee. Lodhi 5 will be responsible for the payment of an 8% administration fee which is payable in 120 instalments. Lodhi 5 Properties Investments defaulted on repayments and First Rand Bank applied to the High court, for an order to compel that Mr Lodhi pay the outstanding balance.<sup>455</sup> The defendant Mr Lodhi

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<sup>452</sup> Maphuti DT *Lodhi 5 Properties Investments v FirstRand Bank Limited* (2015) 3 ALL SA 32 (SCA) and the enforcement of Islamic banking law in South Africa

<sup>453</sup> FirstRand was created in its current form in February 1998 through the disposal of Anglo American’s interests in First National Bank and Southern Life, and the merger of these assets with RMB and Momentum; one of the largest transactions in the history of local financial services. <http://www.firstrand.co.za/AboutUs/Pages/ownership-structure-and-operating-model.aspx> (accessed 10 July 2017)

<sup>454</sup> The term *Wakala* is used in Islamic finance to describe a contract of agency or delegated authority pursuant to which the principal appoints an agent to carry out a specific task on its behalf. The *Wakala* concept is used frequently in financing transactions, including sale and purchase (where the agent can buy or sell assets on behalf of the principal that appointed it), borrowing and lending of funds and assignment of debt, guarantees and pledges <http://www.ifre.com/exploring-islamic-agency/1611511.fullarticle> (accessed 12 July 2017)

<sup>455</sup> Maphuti DT *Lodhi 5 Properties Investments v FirstRand Bank Limited* ((2015) 3 ALL SA 32 (SCA) and the enforcement of Islamic banking law in South Africa

raised the defence that the loan and agency agreement are void as they are not *Shariah* compliant. The defendants further alleged that the agreements were not explained, no performance was rendered by First Rand Bank, and that the charging of administration fee amounts *Riba*, which were in conflict with *Shariah* law.<sup>456</sup>

The High Court approached the matter by analysing both the loan and agency agreements. The High Court concluded that the loan agreement was not a profit sharing agreement because both parties did not benefit from the agreement.<sup>457</sup> The agreement was a residential property offered with a fixed agency fee. The High Court further concluded that the loan and agency contracts were in accordance with *Shariah*.<sup>458</sup> The court ordered Mr Lodhi to make a payment to the applicant of the cumulative sum of R10 328 574, 25 plus interest at the rate of 15.5% per annum.<sup>459</sup> The Supreme Court of appeal also arrived at a similar decision.<sup>460</sup>

The Supreme Court of Appeal approached this matter by analysing the type of interest charged in terms of the agreement between the parties. The courts view, was the mora interest was not interest in terms of a loan contract but a form of damages due to the respondent failing to perform a contractual obligation within an agreed time. The court's opinion is that this contractual obligation had "nothing to do with and is not affected by *Shariah* laws

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<sup>456</sup> Maphuti DT *Lodhi 5 Properties Investments v FirstRand Bank Limited* ((2015) 3 ALL SA 32 (SCA) and the enforcement of Islamic banking law in South Africa

<sup>457</sup> *Lodhi 5 Properties Investments v FirstRand Bank Limited* ((2015) 3 ALL SA 32 Paragraph 125

<sup>458</sup> *Lodhi 5 Properties Investments CC v FirstRand Bank Limited* [2015] 3 All SA 32 Paragraph 128

<sup>459</sup> *Lodhi 5 Properties Investments CC v FirstRand Bank Limited* [2015] 3 All SA 32 Paragraph 131

<sup>460</sup> *Lodhi 5 Properties Investments CC v FirstRand Bank Limited* [2015] 3 All SA 32 Paragraph 131

prohibition against payment of interest on a loan debt.”<sup>461</sup> The Supreme court of Appeal dismissed the debtors appeal and upheld that the debtor is liable to pay the interest claimed by the bank and applied the Prescribed Rate of Interest Act 55 of 1975.<sup>462</sup>

The decision in *Lodhi 5* confirms the reluctance of courts to accept and enforce the application of Islamic law. The High Court and Supreme Courts were unfamiliar with the meaning of *Shariah* law and failed to consult with Muslim experts for guidance.<sup>463</sup> The courts failed to decide on the enforcement of Islamic law. The courts did not address the questions on prohibition of *Riba*, as well as whether agency fees are *Shariah*-compliant or not.<sup>464</sup> This case also demonstrates the challenges that courts are faced with when they are confronted with the interpretation and application of uncodified *Shariah* law, which has been the subject of various scholarly interpretations. It also illustrates the challenges encountered by common law courts with no expertise to interpret and enforce transactions which are subject to Sharia law.<sup>465</sup> The High court and the Supreme Court of Appeal were unsuccessful in addressing several issues which called for the interpretation of the relevant

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<sup>461</sup> Tuba MD " *Lodhi 5 Properties Investments CC v FirstRand Bank Limited* [2015] 3 All SA 32 (SCA) and the Enforcement of Islamic Banking Law in South Africa" *PER / PELJ* 2017(20) - DOI <http://dx.doi.org/10.17159/1727-3781/2017/v20n0a1308> ( accessed 12 July 2017)

<sup>462</sup>. Section 1(1) of the Prescribed Rate of Interest Act 55 of 1975 provides that if a debt bears interest and the rate at which the interest is to be calculated is not governed by any other law or by an agreement or a trade custom or in any other manner, such interest shall be calculated at the rate prescribed under subsection (2) as at the time when such interest begins to run, unless a court of law, on grounds of special circumstances relating to that debt, orders otherwise.'

<sup>463</sup> *Ibid*

<sup>464</sup> *Ibid*

<sup>465</sup> Tuba MD " *Lodhi 5 Properties Investments CC v FirstRand Bank Limited* [2015] 3 All SA 32 (SCA) and the Enforcement of Islamic Banking Law in South Africa" *PER / PELJ* 2017(20) - DOI <http://dx.doi.org/10.17159/1727-3781/2017/v20n0a1308> (accessed 15 January 2018)

Islamic finance principles, and thus left more questions unresolved than those that were effectively answered.<sup>466</sup>

South African courts need to consider cultural relativism which means that a person's beliefs, values, and practices should be understood based on that person's own culture, rather than judged against the criteria of another.<sup>467</sup> This can be used to answer the crux of the question as to whether or not the enforcement and application of an Islamic transaction is to be judged by Islamic law or South African Law.

### **5.8 Conclusion**

In the development of Islamic compliant financial products in South Africa, various problems arise, with the undertaking to give legal effect, to a system modelled to execute Islamic law.<sup>468</sup> Notwithstanding, the fact, that the principle of freedom of contract allows Muslims the freedom to expand its commodities, the devising of an Islamic legal framework, in a manner that is secure and beneficial in South Africa is much sought after. Islamic law compliance is restricted to marketing material claims and without the claims trickling down to the composition of the commodities or to clear recognition as valid instruments by the law.<sup>469</sup>

There is a population of about 1 million Muslims in South Africa who have an interest in the recognition and acceptance of Islamic based insurance. The interest of this sector lies not just in the acceptance of financial instruments

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<sup>466</sup> Tuba MD " *Lodhi 5 Properties Investments CC v FirstRand Bank Limited* [2015] 3 All SA 32 (SCA) and the Enforcement of Islamic Banking Law in South Africa" *PER / PELJ* 2017(20) - DOI <http://dx.doi.org/10.17159/1727-3781/2017/v20n0a1308> (accessed 15 January 2018)

<sup>467</sup> Definition of Cultural Relativism <http://www.chegg.com/homework-help/definitions/cultural-relativism-49> (accessed 28 September 2017)

<sup>468</sup> Suleman S "Doing business with Muslim communities BG Bowman Gilfillan Attorneys" <http://www.bowman.co.za/eazines/CorporateMarch.htm> (accessed 25 March 2015)

<sup>469</sup> Ibid

based on Islamic law as part of South African law but through judicial recognition of their religious rights. Freedom of religion is not an absolute right and it is a challenge to implement the bill of rights, therefore the South African legislators have a daunting task ahead to balance the interests of justices against the interests of minorities.



## CHAPTER SIX: SUMMARY AND RECOMMENDATIONS

### 6.1 Summary

In South Africa, Islamic finance and insurance are governed under existing conventional legislation. The South African legislative frameworks are based on interest, speculation and uncertainty and therefore are not aligned with the principles that are under the Islamic financial system. South African insurance products involve uncertainty, gambling, interest and can be a subject of exploitation because insurance companies are guided by the principle of profit maximisation and not for the interests of the insured. In South African insurance law, the insurance contract is between the insurer and the insured and the premiums can be utilised as the insurer deems fit whilst in *Takaful*, premiums belong to insured and the funds are invested according to the interest of the clients. On the one hand, Islamic contracts, including financial and insurance contracts enjoy recognition in South Africa but on the other hand, there is currently no separate South African regulation dealing specifically with Islamic contracts, which means that it is regulated by the laws governing conventional insurance.<sup>470</sup> One of the difficulties is that the parties reach consensus on their terms and conditions of an agreement but the South African courts have a difficult time interpreting and imposing the conditions as a set of in the contract. In spite of the *Constitution* of South Africa, recognising freedom of religion and trade, the freedom in many cases is legitimately limited and is not absolute.<sup>471</sup> The challenges that comes with adjudicating religious disputes was highlighted in *Prince v President, Cape Law Society, and Others*<sup>472</sup> where Ngcobo J observed that: ‘Human beings may freely believe in what they cannot prove and that although ‘their beliefs are bizarre, illogical or irrational to others, or are incapable of scientific proof, [this] does not detract from the

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<sup>470</sup> Ibid

<sup>471</sup> *Prince v President, Cape Law Society, and Others* 2002 (2) SA 794 (CC) at para 42

<sup>472</sup> 2002 (2) SA 794 (CC)

fact that these are religious beliefs for the purposes of enjoying the protection guaranteed by the right to freedom of religion and they should not be put to the proof of their beliefs or faith. The doctrine also draws from the widely accepted principle that a state (and its organs) should be a-religious to ensure religious freedom and equality.<sup>473</sup>

The South African legal system provides for the recognition of Islamic law but the system has many limitations. The lack of codified body of law or precedents in Islamic law results in the difficulty for the South African judiciary to implement and apply Islamic law. The question whether common law or customary law should be applied in court leads to conflict. This conflict of laws has always been a challenge for courts for decades.

Courts and litigants need a clear and explicit choice of law rules to indicate when the common or customary law will be applicable to the facts of a particular case. The decision in *Lodhi 5 Properties Investment CC V First Rand Bank Limited*<sup>474</sup> brought about a renewed enthusiasm in our courts to adjudicate on matters relating to Islamic law. Islamic banking and *Takaful* law is already part of South African law.<sup>475</sup> Islamic law has, however, yet to be given detailed clarification by our courts. This poses a question as to whether our courts, which are grounded in the common law, are willing to adopt and apply the principles of *Takaful* in South African law.

The Reserve Banks Act 90 of 1989, Banks Act 94 of 1990, Mutual Banks Act 124 of 1993, Co-operative Banks Act 40 of 2007, Long-term Insurance Act 52 of 1998, Short-Term Insurance Act 53 of 1998 and the Financial Services Boards Act 97 of 1990 which govern the conventional financial Institutions in South Africa do not forbid Islamic financial products however, they do not take

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<sup>473</sup> *Prince v President, Cape Law Society, and Others* 2002 (2) SA 794 (CC) at paragraph 42

<sup>474</sup> (2015) 3 ALL SA 32 (SCA)

<sup>475</sup> *Albaraka Bank Ltd v Halaal Royal Snacks (Pty) Ltd* (SGHC) unreported case number 08400/2010 para 4, Mudaraba and other Islamic finance products are now incorporated into the *Income Tax Act* 58 of 1962 in terms of the Taxation Laws Amendment Act 24 of 2011

into account the prohibitions centred upon the Islamic economic system. Therefore, the Islamic institutions also have no option but to rely on the frameworks developed by their conventional counterparts.

A comprehensive legal framework is of utmost importance to guarantee a favorable outcome on the implementation of any Islamic banking system. The comprehensive legal infrastructure for Islamic finance is unique to South Africa and essentially reflects the support and dedication by the legal fraternity in keeping abreast with the development of Islamic finance.

Moving forward, with the existence of a dedicated court for Islamic finance, competent human capital and consistent legal precedents, South Africa is well-placed to serve as a platform for adjudication and dispute settlement.

Irrespective of the Islamic law development in South Africa, the South African conventional legal frameworks caters for the needs of conventional banks and not Islamic banks. This *lacuna* in South African law needs to be addressed because it results in uncertainty in law and various interpretations.

In South Africa, there is an absence of sufficiently qualified experts and a supervisory body or institution for regulations and recommendation for matters regarding Islamic law.

## 6.2 Recommendations

An important component in developing an effective legal infrastructure is the role of an adjudication system. A supportive adjudication system in the context of Islamic finance and insurance is one which can authoritatively enforce the principles of *Shariah* in dispute settlements involving Islamic financial and insurance transactions. This helps create certainty and establishes the legitimacy of Islamic financial contracts.

Islamic commercial law consists of many different types of contracts including *Takaful* contracts. The enforcement of contracts is critical as it is essential to economic development and sustained growth. Dispute settlement is regarded as a pillar of any legal system. Therefore, there is a paramount need for a dispute settlement system that is able and competent to examine *Shariah* matters in contracts, so that issues of dispute in *Shariah* interpretation could be resolved and enforced accordingly. A potential solution is to create an Islamic bench in the South African judiciary system that deals with financial transactions undertaken in accordance with the *Shariah*. This will enable the accommodation of *Takaful* into the South African system.

From the analysis and the practices in the *Shariah* legal system, it is quite obvious that the recognition of Islamic law of finance as part of South African law through legislation will be difficult. The difficulties involved in this approach are that firstly there is considerable conflict between Islamic law of finance and Insurance and South African law which has been discussed previously. Secondly, it will place the courts into turmoil with regards to understanding, interpreting and applying the Islamic law of finance in South African cases.

The main objective of this study was to analyse the accommodation of Islamic law of *Takaful* into South African Law. The recognition of Islamic law as customary law will be challenging. This recognition is feasible only if and when there is clarity available through a codified body of law of Islamic law drawn by international and South African authorities on the subject which will ease the courts of the difficulty of interpretation and application.

The attempt to recognise Islamic law products only and not the system of Islamic law relating to finance as a whole will be difficult. The codification, if one can call it that, would be that off the law relating to a particular financial instruments and not the substantial part of law which inescapably be a monumental, if not an impossible task. In addition to this they would be a need to establish a supervisory board whose task will be to interpret, regulate and make recommendations for current practice and future development. This third option is recommended. However, there is a need for further research in this direction do this.

The Insurance industry whilst emphasising in their marketing efforts to the *Halaal* nature of *Takaful* as offered in South Africa would have to come up with products in which the nature, scope, limitations would be adequately described for a Law Commission to be appointed. This will enable the recommendation of legislation in the likeness in the Long-Term insurance Act and the Short-term Insurance Act to be consistent with South Africa legal principles for adoption into law by parliament. The advantage of this approach would be that legal certainty will be attained.

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