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DISCHARGE OF CONTRACT AND SURRENDER UNDER LIFE INSURANCE AND FAMILY TAKAFUL: A COMPARATIVE STUDY

(Pelepasan Kontrak dan Penyerahan di Bawah Insurans Hayat dan
Takaful Keluarga: Satu Kajian Perbandingan)

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ABSTRACT

This is a doctrinal and comparative research between the traditional law and the *syariah* with regard to discharge of policies and surrender. The aim is to find similarities and dissimilarities between life insurance and family takaful vis-à-vis the issues. The issues are: Discharge of life policies/family takaful and this will cover discharge by Performance; Payment by Mistake; discharge by agreement, discharge by breach and cancellation. Moreover, the researcher explore surrender under life insurance and family takaful, which will deliberate on the concept and procedure for surrender. It has been found that both the traditional law and the *syariah* agree that a contract of life insurance and family takaful may be discharged by performance, by agreement, by breach, payment by mistake and cancellation. With regard to surrender, it has been found that both the Financial Services Act 2013 and the Islamic Financial Services Act 2013 allow it. It has been submitted that surrender is not against the *syariah*, since the purpose is to ensure good for the participants provided it is done in accordance with fair dealing. Moreover, both the traditional law and the *syariah* share the same view in the procedure for the surrender as it is required to be in a writing form.

Keywords: Surrender; discharge; contract; family takaful; life insurance

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ABSTRAK

Artikel ini merupakan kajian doktrin dan kajian perbandingan di antara undang-undang tradisional dan undang-undang syariah yang berkaitan dengan penamatan polisi dan serahan (pembatalan polisi). Tujuan kajian adalah untuk mencari persamaan dan perbezaan di antara insurans hayat dan takaful keluarga berkaitan isu-isu tertentu. Isu-isu yang dimaksudkan adalah Penamatan Polisi Hayat/Takaful Keluarga merangkumi Penamatan Secara Tindakan; Kesalahan Pembayaran; Penamatan Secara Persetujuan, Penamatan dengan Kemungkiran dan Pembatalan. Selain itu, penyelidik juga akan mengkaji dan membincangkan mengenai konsep dan prosedur bagi serahan di bawah insurans hayat dan takaful keluarga. Adalah didapati bahawa kedua-dua undang-undang tradisional dan syariah bersetuju bahawa kontrak insurans hayat dan takaful keluarga boleh ditamatkan sama ada secara tindakan, secara persetujuan, secara kemungkiran, kesilapan pembayaran atau pembatalan. Dalam hal ini, kedua-dua akta iaitu Akta Perkhidmatan Kewangan 2013 dan Akta Perkhidmatan Kewangan Islam 2013 didapati membenarkannya serahan. Ia juga mengesahkan bahawa penamatan dengan serahan tidak bertentangan dengan undang-undang syariah kerana ia bertujuan untuk memastikan kebaikan kepada para peserta dengan syarat ia dilakukan mengikut dengan tatacara yang sewajarnya. Selain itu, kedua-dua undang-undang tradisional dan syariah berkongsi pandangan yang sama dalam prosedur bagi serahan dimana ia mesti dilakukan di dalam bentuk bertulis.

Kata kunci: Penamatan; pelepasan; kontrak; takaful keluarga; takaful hayat.

INTRODUCTION

This study would look into some issues under life insurance and family *takaful*. The aim is to find similarities and dissimilarities between life insurance and family *takaful vis-à-vis* the issues. The issues are discharge of life policies/family *takaful* and it also cover discharge by performance, payment by mistake, discharge by agreement, discharge by breach and cancellation. Moreover, the researcher explore surrender under life insurance and family *takaful*, which will deliberate on the concept and procedure for surrender. Section I of this research is the introduction. Section II overviews discharge of life policies/family *takaful* it also will cover discharge by performance, payment by mistake, discharge by agreement, discharge by breach and cancellation. Section III delineates surrender under life insurance and family *takaful*, which will deliberate on the concept and procedure for surrender. Finally, Section IV which is the conclusion summarises the research findings and presents the author's opinion on the issues.

DISCHARGE OF LIFE POLICIES

According to the traditional law, when a contractual obligation is released and the contract is brought to an end, it said to be discharged (Houseman & Davies 2003). The following is a discussion on how an obligation under a life policy/family *takaful* may be discharged.

Discharge by Performance

A contract is discharged by performance i.e. by one party carrying out the obligations under the contract. In case of life insurance policy, the payment of the benefits, upon the happening of the event prescribed in the policy, discharges the insurer from their obligation under the policy by way of performance. Payment of the insurance monies under the majority of life policies are made to the insured if he survives the term (in case of term insurances) or to his executor or administrator on proof of title or proof of age when so required under the policy. Upon settlement of the policy monies, the insurer is discharged and released from all its obligations to pay the monies due under the policy. It is common for insurer to insist on a formal discharge from the claimant releasing them from all the claims under the policy. However, an insurer is not entitled to insist upon the claimant signing a formal discharge for the policy monies or to withhold payment until it receives a formal discharge for payment (Houseman & Davie 2003).

Under family *takaful*, based on the *Islamic Financial Services Act 2013*, licensed *takaful* operator shall be discharged from liability for payments of *takaful* benefits under a *takaful* certificate if the licensed *takaful* operator pays the *takaful* benefits to the nominee named in the *takaful* certificate whether that nominee receives the *takaful* benefits as an executor or as a beneficiary (*Islamic Financial Services Act 2003*: Schedule 10, Section 142, Para 6 (1)). Basically, under the *syariah*, one of the ways of discharging contracts is by performance (Islam 1998). Hence, under family *takaful*, once the operator pays the benefits either to the participants if he survives until maturity or to his executor or any nominee under the family *takaful* certificate, the operator is said to be discharged from all obligations under the family *takaful* certificate. Thus, both the traditional law and the *syariah* consider the insurer/operator as being discharged from obligations under the life insurance policy/family *takaful* certificate once the benefits are paid to the policy holder/participant or nominee/executor.

Payment by Mistake

Basically, an insurer is bound by a settlement which he had made with an insured *Holmes v Payne [1930] 2 K.B. 301*. Mistakes may be classified into: common

mistakes; mutual mistakes; and unilateral mistakes *Tham Kong v Oh Hiam & Ors* [1968] 1 MLJ 44; [1980] 2 MLJ 159 (PC). Mistakes are common where both parties make the same mistake. Each knows the intention of the other and accepts it, but is mistaken about some underlying and fundamental fact. The mistake is mutual where the parties misunderstand each other and are at cross purposes. In unilateral mistakes, only one of the parties suffers some mistake (Dass 2000). Basically, under insurance contract, the insurer is entitled to have an agreement set aside on the ground of unilateral mistake if it turns out that the insured has no basis for his claim *Magee v Pennie Insurance Co. Ltd* [1969] 2 Q.B. 507; [1969] 2 All E.R. 891. The insurer, who has made payment under mistake, will be able to recover what had been paid pursuant to Section 166 of the *Contracts Act 1950*.

Under the *syariah*, a mistake is known in the Islamic contract law as *ghalat* (Md. Abdul Jalil 2010). Under both the common law of England and the Islamic law of contract, mutual mistake can vitiate a contract. However, in the case of a unilateral mistake, the common law says, the contract is valid (M.P. Lee 2007). But in the Islamic contract law even a unilateral mistake may nullify a contract based on the fact and circumstances of the case (Md. Abdul Jalil 2010). Thus, from the foregoing a mistake in family *takaful* may nullify the contract the circumstances of the case points to that.

Discharge by Agreement

Based on the traditional law, the policy represents the agreement between the insurer and the insured and the policy can provide the situation when the policy can be terminated thereby releasing the parties of their obligations under the policy. An example of this would be where the parties agree that on surrender of the policy for a cash payment, the policy shall be null and void (Dass 2000).

Under the *syariah*, it is submitted that discharge under the family *takaful* certificate can be by agreement. Under the *syariah*, an express agreement has been identified as a means of discharging a contract (Islam 1998). This is because under the *syariah*, an express agreement between parties involved in a contract to discharge one of the parties from all obligations is acceptable under the *syariah*. Therefore, any agreement between the operator and the participant that discharges the operator from obligations is acceptable as long as it is done with free consent. Hence, the both *syariah* and the traditional law allow discharge by agreement in order to release one of the parties from obligations under life insurance and family *takaful*.

Discharge by Breach

Under the traditional law, the right of one party to treat a contract as discharged by breach arises in two types of situations: where one party has committed a fundamental breach i.e. having regard to the contract as a whole, the obligation or condition which has been broken is of major importance or going to the root of the matter; where the party in dispute has repudiated the contract before performance is due or before it is fully performed. Life insurance policies may also have specific provisions providing for termination of the policy in the event of breach of any of the conditions e.g. payment of premium. Failure to pay premium within the stipulated period set out in the policy would lead to the lapse of the policy or reduction of benefits. Taking part in activities prohibited by the conditions of the policy (e.g. partaking in hazardous activities, racing, certain aviation activities etc.) would also lead to exclusion of coverage by the insurer thus discharging them from their liability under the policy (Dass 2000).

Under the *syariah*, a contract is discharged by breach. Discharge of a contract by breach is accepted under the *syariah* (Islam 1998). Therefore, if there is an agreement between the operator and the participants pertaining to the grounds which if breached the family certificate is discharged, then upon commission of one of those grounds the family certificate should be discharged. Thus, it all depends on the grounds that may amount to discharge by breach that is agreed upon between the operator and the participant. Hence, both the *syariah* and the traditional law agree that a contract of life insurance and family *takaful* may be discharged by breach.

Cancellation

Based on the traditional law, a policy owner may, within fifteen days or such longer period as may be specified by the bank after the delivery of a life policy of any description to him, return the life policy to the licensed life insurer and it shall immediately refund any premium which has been paid in respect of the life policy subject only to the deduction of expenses incurred for the medical examination of the life insured *Financial Services Act 2013, Schedule 8, Section 128, Para 2(1)*.

Under family *takaful*, based on the *Islamic Financial Services Act 2013*, a *takaful* participant may, within days or such longer period as may be specified by the Bank after the delivery of a family *takaful* certificate of any description to him, return the family *takaful* certificate to the licensed family operator and it shall immediately refund any *takaful* contribution which has been paid in respect of the family *takaful* certificate subject only to deduction of expenses incurred for the medical examination of the person covered *Islamic Financial Services Act 2013: Schedule 8, Section 140, Paragraph 2(1)*. Furthermore, it is well entrenched in Islamic Law that *khiyar* is an

inherent right of the contracting parties in a contract. This right provides the contracting parties with a right of option to void the contract they entered into if the subject matter of the contract does not comply with the specifications, terms and conditions of the contract (Md. Dahlan 1989).

Therefore, under the *syariah*, a participant in should be given right to return *takaful* certificate to the licensed family operator and it shall immediately refund any *takaful* contribution which has been paid in respect of the family *takaful* certificate based on the concept of *khiyar*. Hence, both the *syariah* and the traditional law share the same view that a party in a life insurance policy or family *takaful* certificate should have the right to cancel the contract within a stipulated period of time.

SURRENDER

Surrender value is the amount the policyholder will get from the life insurance company if he decides to exit the policy before maturity. According to the *Financial Services Act 2013*, at any time after the inception of a policy which provides for surrender value, the policy owner may, by notice in writing to the licensed life insurer, surrender the life policy, and he shall be entitled to receive the surrender value of the policy *Financial Services Act 2013, Schedule 8, section 128, para 6 (1)*.

Under family *takaful*, according to the *Islamic Financial Service Act 2013*, at any time after inception of a family *takaful* certificate which provides for surrender value, the *takaful* participant may, by notice in writing to the licensed family *takaful* operator, surrender the family *takaful* certificate, and he shall be entitled to receive the surrender value of the family *takaful* certificate *Islamic Financial Service Act 2013: Schedule 8, Section 140, para 6 (1)*. And also *takaful* benefits payable under a family *takaful* certificate, or *takaful* benefits payable under the surrender of a family *takaful* certificate, shall be paid without any deduction for money not due under the family *takaful* certificate or under an assignment of the family *takaful* certificate, unless the deduction is made with the consent of the person entitled to the *takaful* benefits *Islamic Financial Service Act 2013: Schedule 8, Section 140, para 5 (1)*. The surrender benefits are the amount of balance in the PA account. But the instalments of the PSA account are not refundable because they are *tabarru* (Mohammed Fadzli 1996).

Thus, the ‘surrender value’ is not against the *syariah*, since the purpose is to ensure good for the participants. However, the ‘surrender value’ practice shall be in accordance with fair dealing, and that is why Section 140, para 6 (1) (b) & (c) of the *Islamic Financial Services Act 2013* stated that “in a manner ensuring the fair

treatment of *takaful* participants” and “in compliance with standards on business conduct or fair treatment of *takaful* participants specified by the Bank”. Therefore, the traditional and the *syariah* do not differ with each other as both allow the practice of ‘surrender’ value. But, generally as mentioned before, the *syariah* does not approve interest in all dealings. Thus, any element of interest in the practice of the ‘surrender value’ is against the *syariah*.

Procedure for Surrender

The procedure for surrender is completed by requesting some documents by the insurers, namely: a discharge form signed by the policy owner; the original policy document. If the policy is destroyed or missing, a statutory declaration from the policy owner may be obtained; the application for surrender; and deed of assignment or trust deed if the person claiming is other than the policy owner (Dass 2000).

It appears from above that procedure for the surrender under the traditional law aim to ensure that everything is documented. Basically, this is a philosophy that the traditional law shares with the *syariah* pertaining to documenting agreements. The *syariah* requires that agreement should be written to avoid any likely misunderstanding that may occur in the future. Allah (May He be exalted) says “O ye who believe! When ye deal with each other, in transactions involving future obligations in a fixed period of time reduce them to writing” (al- Baqarah 2: 282). Therefore, it could be said that the *syariah* and the traditional law share the same philosophy of writing agreements to ensure no disagreement will occur in the future. Therefore, under both the *syariah* and the traditional law, all the process of the surrender should be documented in order to avoid any likely misunderstanding in the future.

CONCLUSION

It is therefore concluded that both the traditional law and the *syariah* agree that a contract of life insurance and family *takaful* may be discharged by performance, by agreement, by breach, payment by mistake and cancellation. With regard to surrender, it has been found that both the *Financial Services Act 2013* and the *Islamic Financial Services Act 2013* allow it. Therefore, it is submitted that surrender is not against the *syariah*, since the purpose is to ensure good for the participants provided it is done in accordance with fair dealing. Moreover, both the traditional law and the *syariah* share the same view in the procedure for the surrender as it is required to be in a writing form.

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