

CHAPTER 2

LITERATURE REVIEW

2.1 Definition and Origin

2.1.1 Insurance

The term insurance in its real sense is community pooling to alleviate the burden of the individual, lest it should ruinous to him. It may be defined more formally as a system under which the insurer, for a consideration usually agreed upon in advance, promises to reimburse the insured or to render services to the insured in the event that certain accidental occurrences result in losses during a given period.¹

Willet, Kulp, Riegel, and Miller and Pfeffer, all provide similar definitions. Underlying these definitions is the concept of risk pooling of group sharing of losses. That is, persons exposed to loss from a particular source combine their risk and agree to share losses on some equitable basis. The risks may be combined under an arrangement whereby the participants mutually insure each other a plan which is appropriately designated 'mutual insurance'; or they may be transferred to an organization which, for a consideration, called the 'premium', is willing to assume the risks and pay the resulting losses.² By this definition, insurance is regarded as a tool of risk sharing and risk transfer.

The idea of insurance began with the Babylonians and their civilizations, which flourished some 3000 years B.C. The Code of Hammurabi showed that the ancient Babylonians used to practice commercial contracts involving money transactions, in which people lent their money to the merchants for a certain percentage of interest. This money transaction subsequently becomes known to the world as Contract of Bottomry.

¹ The New Encyclopedia Britannica , (1998), Volume 21, USA : Encyclopedia Britannica Inc, p.741

² Hardy Ivamy, E.R.(1975), **General Principles of Insurance Law**, London : Butterworth, p.3

Bottomry is a commercial contract whereby money or goods was advanced for trade purposes either as true loans at a certain fixed rate of interest under which the lender had no right to any share in the proceedings of the trading venture, or as a mixed loans and partnerships which, in addition to the payment of a fixed rate of interest to the lender irrespective of the result of the trading, entitled him to receive a share of the profits, if such profits exceeded a certain sum.

This was on the understanding that the borrower should, in consideration of a high rate of interest, be freed from liability in the event of certain accidents happening, e.g. failure of goods to arrive at their intended destination. Should the goods arrive, however, the borrower would then be liable for repayment of the loan, plus interest. Knowledge of these arrangements was then transmitted through the Phoenicians to the Greeks, Hindus and Roman.³

2.1.2 *Takaful*

On the other hand, *Takaful* comes from the Arabic word *kafala*, means joint guarantee. Thus it can be visualized as a pact among a group of members or participants who agree to jointly guarantee among themselves against loss or damage that may inflict upon any of them as defined in the pact. Should any member or participant suffer a catastrophe or disaster he would receive a certain sum of money or financial benefit from a fund, as also defined in the pact, to help him meet the loss or damage.⁴ In other words, the basic objective of *takaful* is to pay for a defined loss from a defined fund. Each member of the group pools effort to support the needy. Hence a *takaful* is better known as cooperative insurance.

Section 2 of the *Takaful Act 1984* defines *Takaful* as "a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual

³ Mohd. Ma'sum Billah (2001), *Principles and Practices of Takaful and Insurance Compared*, Kuala Lumpur : IIUM Press, p.11-13

⁴ Mohd. Fadzli Yusof (1996), *Takaful : Sistem Insurans Islam*, Kuala Lumpur : Utusan Publications and Distributors Sdn. Bhd., pp13-14

financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose”.

The essence of *takaful* could be seen in the system of mutual help in relation to the custom of blood money under the Arab tribal custom. Under this tradition, the entire tribe was held responsible for the payment of blood money to the tribe or the relatives of the killed. The object of this payment is to secure protection against danger to which all the members of the tribe are equally exposed and to eliminate a common danger which may fall upon any member of the tribe at any time. Accordingly, the tribe jointly contributed to meet the loss (in blood money) which might fall upon any of them. In other words, it is a mutual coverage of accidental loss by the community to a common danger.⁵

After the advent of Islam, the system of compensation for loss of life, i.e. blood money, because of its virtues and benefits, was retained in the Islamic discipline.⁶ A group of Muslims was held responsible by the unwritten law for the payment of blood-wit for any of its members. In common terminology, it is called '*aqilah*' and based on the ideology of common interest.⁷ According to the conception of '*aqilah*', a clan is committed by the unwritten law of Arab tribes to pay the blood-wit for each of its members. On the basis of these principles, Islamic system of insurance embodies the elements of shared responsibility, joint indemnity, common interest, solidarity, etc.⁸

⁵ Afzalur Rahman, *Islamic Banking and Insurance*, London : Islamic Foundation, pp.64--67

⁶ "O you who believe! Al-Qisas (the law of equality in punishment) is prescribed for you in case of murder: the free for free, the slave for the slave, and the female for the female. But if the killer is forgiven by the brother (or the relatives, etc.) of the killed against blood money, then adhering to it with fairness and payment of the blood money to the heir should be made in fairness. This is alleviation and a mercy from your Lord. So after this whoever transgresses the limits (i.e. kills the killer after taking the blood money), he shall have a painful torment." - Surah Al-Baqarah:178-179.

⁷ '*Aqilah* is the name of the man's male relations who according to the precept of the religious law have to pay the penalty for him, when unintentionally he has caused the death of a Muslim.

⁸ Apart from the system of '*aqilah*', there are two other Islamic systems which resemble insurance system, namely *al-Qasamah* and *al-muwallah*. Under the system of *al-Qasamah*, members of a clan establish and make periodic contributions to an agreed fund. The fund will be used to pay compensation for beneficiaries of a killed member if the killer(s) is unknown or in the case of no trustworthy witness available. On the other hand, the contract of *al-muwallah* is a contract of suretyship. Under this contract, a person will guarantee another e.g. a convert Muslim or an immigrant that does not have any relative. The guarantor is liable to pay blood-wit or penalty if the person he guaranteed involved in a crime.

2.2 Basic Principles of Insurance

2.2.1 Indemnity

Indemnity principle is a legal doctrine stating that the function of insurance is to repay (indemnify) insured for their actual losses. Policyholders who have adequate insurance protection are to be restored to the financial position they held before the losses occurred, but they should not profit from the insurance. This principle applies most fully to property and liability insurance and less applicable to life and health insurance. The principle is supported by several other principles as pointed out afterward.

2.2.2 Insurable Interest

The indemnity principle requires people to have an insurable interest in whatever they insure. Insured must be in a position to sustain financial loss if the event insured against occurs. This rule prevents the use of insurance as a speculative, profit-making device. It is required for all type of coverage including life insurance.⁹ Insurable interest in life insurance must exist at the inception of the policy, but it does not have to prevail at the time of loss. However, in property and liability insurance the opposite is true.

2.2.3 Subrogation

Subrogation is a legal principle that provides that to the extent an insurer has paid for a loss, the insurer obtains the rights of its policyholder to recover from any third party who caused the loss. The fundamental point is that the insured is entitled to indemnity but no more than that. In other words, subrogation allows the insurer to recoup any profit the insured might take from an insured event. It also allows them to pursue any rights or remedies which the insured

⁹ There are two types of insurable interest in life insurance; (1) Insurable interest based upon close family relationship, such as between husband and wife; and (2) Insurable interest based upon specific financial interest in the insured person, such as a creditor in the life of a debtor. In non-life insurance the usual sources of insurable interest are the ownership of property and

may possess, which may reduce the loss. Most property insurance policies contain a provision reinforcing this principle.

2.2.4 Contribution

Contribution is the right of an insurer to recall upon others similarly, but not necessarily equally liable to the same insured to share the cost of an indemnity payment. The fundamental point here is that if an insurer has paid a full indemnity, it can recoup an equitable proportion from the other insurers of the risk. If a full indemnity has not been paid, then the insured will wish to claim from the others also to receive an indemnity and the principle of contribution enables the total claim to be shared in a fair manner. The basis of contribution is that the loss will be shared by the insurers in their 'rateable proportions'.¹⁰

2.2.5 Proximate Cause

Proximate cause means the active, efficient cause that sets in motion a train of events which brings about a result, without the intervention of any force started and working actively from a new and independent source. The proximate cause is not the first cause, nor the last cause, it is the dominant cause or the efficient or operative cause. In general, causation is to be understood by the man in the street and by applying common sense standards.

2.2.6 Utmost Good Faith

The practical effect of the principle of utmost good faith lies in the requirement that the applicant for insurance must make full and fair disclosure of the risk to

the obligation to pay debts. Refer to Frederick G.Crane (1980), *Insurance Principles and Practices*, USA : John Wiley and sons Inc., pp.52-53.

¹⁰ There are two interpretations of how rateable proportions should be calculated. Firstly, one could argue that each insurer should pay in proportion to the sum insured or limits of liability on the policies. Alternatively, one could argue that each policy should pay in proportion to its liability for the loss, since account should be taken of restrictive terms which might vary from policy to policy.

the agent and the company. The risk that the company thinks it is assuming must be the same risk that the insured transfers. Any information about the risk that is known to one party should also be known to other. If the insured intentionally fails to inform the insurer any facts that would influence the issue of the policy or the rate at which it would be issued, the insurer may have grounds for avoiding coverage. This principle is reflected today in rules of law concerning warranty, representation and concealment.¹¹

2.3 Basic Principles of *Takaful*

In general, *takaful* as an Islamic version of insurance system, has acknowledged all the above principles as they are not against the *Shari'ah*. In addition to these basic principles, there are several more concepts which are prevalent in the *takaful* operations.

2.3.1 Principle of Mutual Help (*Ta'awun*)

The Islamic model of insurance policy is based on the Divine principles of mutual co-operation and solidarity, as enshrined by Allah The Almighty to the effect:

*"...Help you one another in virtue, righteousness and piety, but do not help one another in sin and transgression"*¹²

¹¹ A warranty is a policy provision making the insurer's responsibility conditional upon some fact or circumstances concerning the risk. For instance, a burglary policy on a jewelry store may contain a warranty that the policyholder will keep a burglar alarm system in operation whenever the store is not open for business. If there is a burglary loss at a time when the alarm system is not functioning the insurer has no obligation to pay. Representations are statements made to an insurer to supply information or to induce it to accept a risk. They may be contained in formal, written applications or they may be oral. The main thrust of the law is that the facts must be as the applicant represents them to be. Misrepresentation of a material fact makes the contract voidable at the option of the company. The misstatement has to be material and must also be within the knowledge of the applicant. Concealment on the other hand, means that the disclosure of proper and accurate information is not all that is required if the knowledge of both parties of the material facts is to be equal. The applicant also has the obligation of voluntarily disclosing material facts concerning the subject matter of the insurance that the company could not be expected to know about. The failure of the insured to disclose such facts constitutes a concealment, and a willful concealment of a material fact will give grounds for voiding the policy. Emmet J.Vaughan et.al (1995), **Essentials of Insurance: A Risk Management Perspective**, USA : John Wiley and Sons Inc., pp.138-141

¹² Surah Al-Maidah 5:2

The Holy Prophet (s.a.w) has also advised the *ummah* to come forward in revealing one's hardship. Among the saying of the Holy Prophet which carry the message are:

".....Narrated by Abu Hurairah from the Holy Prophet (s.a.w) saying that: whosoever removes a worldly hardship from a believer Allah (s.w.t.) will remove from him one of the hardships of the hereafter. Whosoever alleviates the needy person, Allah (s.w.t.) will alleviate from him in this world and the next..."

"Whosoever fulfills the intention of a brother, Allah will fulfill his intentions"

(Reported by Ahmad and Abu Daud)

2.3.2 *Tabarru'*

The concept of *tabarru'* means to donate, to contribute or to give away. In order to eliminate the element of uncertainty as well as gambling, this concept has been incorporated in the *takaful* contract. In relation to this, a participant shall agree to relinquish as *tabarru'*, certain proportion of his *takaful* installments or *takaful* contributions that he agrees or undertakes to pay thus enabling him to fulfill his obligation of mutual help and joint guarantee should any of his fellow participants suffer a defined loss.

In essence, *tabarru'* would enable the participants to perform their deeds in sincerely assisting fellow participants who might suffer a loss or damage due to a catastrophe or disaster. The sharing of profit or surplus that may emerge from the operations of *takaful*, is made only after the obligation of assisting the fellow participants has been fulfilled. It is imperative, therefore, for a *takaful* operator to maintain adequate assets of the defined funds under its care whilst simultaneously striving prudently to ensure the funds are sufficiently protected against undue over-exposure.¹³

¹³ Mohd. Fadzli Yusof, op.cit, pp.18-20

2.3.3 Al-Mudharabah

Al-Mudharabah is the commercial profit-sharing contract between the provider or providers of funds for a business venture and the entrepreneur who actually conducts the business. By this principle, the entrepreneur or *al-Mudharib* (*takaful* operator) will accept payment of the *takaful* installments or *takaful* contributions (premium) termed as *ra's-ul-mal* from investors or providers of capital or fund (*takaful* participants) acting as *Sahib-al-Mal*.

The contract specifies how the profit from the lawful operations of *takaful* managed by the *takaful* operator is to be shared, in accordance with the principle of *al-Mudharabah*, between the participants as the providers of capital and the *takaful* operator as the entrepreneur. The sharing of such profit may be in a ratio 5:5, 6:4, 7:3, etc. as mutually agreed between the contracting parties. Such a contract eliminates the element of *riba* as detected in the practice of conventional insurance.¹⁴

There are different types of *mudharabah* models being adopted. The first model is the pure *mudharabah* model where the *takaful* company and the participant share direct investment income only and the participant is entitled to a hundred percent of the *takaful* fund surplus. No deduction for operational expenses is made prior to the distribution of the investment income. The second model is a modified *mudharabah* model the investment income is ploughed back into the *takaful* fund and the *takaful* company share with the participant the surplus from the *takaful* fund. The third model is also a modified *mudharabah* where both the company and the participant share in both the investment income and the surplus. Deduction for operational expenses is made prior to distribution of the surplus.¹⁵

¹⁴ *ibid.*

¹⁵ Azman Ismail (1997), 'Current and Future Challenges of Takaful Business', a paper presented at the Fourth Islamic Banking and Finance Forum, held at Bahrain from December 8 to December 10 2001, p.9

2.4 Different Views With Regards to Conventional Insurance

The *ulama'* or Muslim jurists have mixed views on the validity of insurance. There are at least three standpoints: Some hold it permissible (*mubah*) provided that it is free from the element of *riba'*; others reject it wholesale; and still others accept it in some of its forms only.¹⁶

Those who hold the permissibility of insurance contract point out that it is a new form of transaction, which does not fall under any category of business practice, and therefore it should be regarded as permissible (*halal*) in accordance with the legal maxim that 'everything is *halal* unless it is specifically forbidden'. Some consider insurance permissible because neither the *Qur'an* nor *Sunnah* explicitly prohibits insurance. In addition, since it is a contract based on welfare (*maslahah*) and since there is no aspect of any harm (*darar*), it complies with the prescribed law. Moreover, insurance has become a common usage (*'urf 'amm*) necessary for the attainment of private and public interest. *'Urf* is considered to be a source of law, as long as it does not contradict the precepts of the *Shari'ah*.¹⁷

On the other hand, the opponents of the modern contract of insurance give several reasons for their objection. They claim that the insurance contract contains a high degree of *gharar* (uncertainty) arising from the ignorance of the precise nature of the rights and obligations of the parties since it depends on events neither of them can determine. It is also a kind of gamble (*maysir*) as the parties of the contract stand to gain or lose depending on a chance happening. Further it involves *riba'* or interest where monetary rewards are given. For these reasons, a number of scholars do not consider insurance in any form permissible.¹⁸

¹⁶ Muhammad Muslehuddin, (Dr) (1969), *Insurance and Islamic Law*, Lahore : Islamic Publications Limited., p.x

¹⁷ Among the '*ulama'* sharing this viewpoint are Shaikh Muhammad 'Abduh, the Hanafi lawyer Shaikh Ibn 'Abidin, Mustafa Ahmad Zarqa' of Damascus, Ahmad taha al-Sanusi, 'Ali al-Khafif, Mohammad Nejatullah Siddiqi and Muhammad Muslehuddin. Refer to Ma'sum Billah, op.cit., p.72.

The third group holds that some forms of insurance are allowed and some are prohibited. Some of them allowed the use of insurance on property but ban life insurance.¹⁹ However, an overwhelming majority of Islamic scholars are now of the opinion that the conventional insurance contract does not in its present form, conform to the *Shari'ah* because it includes an element of *gharar*, based on the practice of *riba'* and a sort of gambling.²⁰ A detail discussion with regards to the above issue will become the next topic of this research.

2.4.1 Element of Interest (*Riba'*) in Insurance

Generally *riba'* is translated into English as interest or usury (exorbitant interest) but it has a much broader meaning under the *Shari'ah* as it literally means increase in or addition to anything. In Islam there is no segregation between interest and usury. There is now general consensus among Muslim scholars and theologians that the term *riba'* covers both interest and usury.

Technically interest is what the creditor charges from the debtor at a fixed rate on the principal he lent, that is, interest. At the time of the revelation of the *Quran*, interest was charged in several ways. For instance, a person sold something and fixed a time limit for the payment of its price, and if the buyer failed to pay it within the fixed period, he was allowed more time but had to pay an additional sum. Or a person lent a sum of money and asked the debtor to pay it back together with an agreed additional sum of money within a fixed period. Or a rate of interest was fixed for a specific period and if the principal along with the interest was not paid within that period, the rate of interest was enhanced for the extended period and so on.²¹

¹⁸ Among the Islamic scholars who in favor of this view are Mustafa Zaid, Abdullah al-Qalqeeli and Jalal Mustafa al-Sayyad.

¹⁹ Among the scholars who accepted this view are Abdur Rahman Isa, Muhammad Bakheet, Mohamad Musa, Muhammad Abu Zahra and Shaikh al-Azhar Shaikh Jad al-Haq Ali Jad al-Haq.

²⁰ Joni Tamkin Borhan (Dr) (2001), '*The Framework and Practice of Islamic Insurance in Malaysia*', a paper presented at Seminar Ekonomi Islam, held at Academy of Islamic Studies University of Malaya on 14 July 2001, p.5

²¹ Afzalur Rahman, op.cit., p.112

The term *riba'* is used in the *Shari'ah* into two senses i.e. *riba' al-nasi'ah* and *riba' al-fadl*.²² *Riba' al-nasi'ah* means to postpone, defer, or wait and refers to the time is allowed for the borrower to repay the loan in return for the 'addition' or the 'premium'. There is absolutely no difference of opinion among all school of Muslim jurisprudence that *riba al-nasi'ah* is *haram* or prohibited. This type of *riba* is also known as *riba al-Qur'an* and *riba al-jahiliyyah*.²³ In short, it contains the following three elements:

1. Excess or surplus over and above the loan capital (principal);
2. Determination of this surplus in relation to time;
3. Bargain to be conditional on the payment of a predetermined surplus to the creditor.

Riba' al-fadl, on the other hand, is defined as *riba'* other than *riba' al-nasi'ah* or *riba'* recognized during the days of *jahiliyyah*. To be specific, this type of *riba'* involves any exchange or transaction of similar types of goods accompanied with surplus or delay. Originally, this type of *riba'* is confined to six commodities or known as *ribawi* items, i.e. gold, silver, wheat, barley, dates and salt.²⁴ However, most Islamic jurists extended the *ribawi* items to include other items or commodities on the basis of certain inherent characteristics of these six commodities. For example, money is perceived as *ribawi* item since it inherits the characteristic of gold and silver.

Islam regards interest or *riba'* as an economic evil harmful to society, economically, socially as well as morally. Therefore the Holy *Qur'an* forbids Muslim to give or take interest. But as this evil was deeply rooted in the economic and social life of the community, the law of prohibition was

²² Chapra, Muhammad Umar (1992), "The Nature of *riba* and Its treatment in the *Qur'an*, *Hadith* and *Fiqh*," *An Introduction to Islamic Finance*, Shaikh Abod Sheikh Ghazali et.al. (eds), Kuala Lumpur : Quill Publications, p.34

²³ Ab. Mumin Ab. Ghani (Dr) (1999), *Sistem Kewangan Islam dan Perlaksanaannya di Malaysia*, Kuala Lumpur : JAKIM, p.119

²⁴ Abu Said al-Khudri reported Allah's Messenger (PBUH) as saying, "*Gold is to be paid by gold, silver by silver, wheat by wheat, barley by barley, dates by dates, and salt by salt, like for like and equal for equal, payment being made hand to hand. He who made an addition to it, or asked for an addition, in fact dealt in usury. The receiver and the giver are equally guilty*"

gradually introduced to avoid unnecessary inconvenience and hardship to the people.²⁵

As far as commercial insurance is concerned, there are two issues that immediately relate insurance with *riba'*;

1. Insurance companies invest the premiums which they have collected, in interest bearing investments;
2. *Riba'* is core to the insurance business because the amount paid in claim more than the premium collected.

In the first issue, it is obvious that most insurance companies do indulge in various activities involving the element of *riba'*. For instance the funds collected in premiums are invested in fixed earnings, i.e. interest investments and only a small portion is invested in other projects. This is because they consider it safe and free from risk, and as their policy is to play safe in order to protect the interest of their clients, fixed earning investments are the most likely choice for them. Apart from that they are also paying interest for their interest-based loans and taking into consideration future interests when determining their premium rates. These practices bring about the problem of *riba' al-nasi'ah*.

The second issue, on the other hand relates insurance with *riba'* because the insured is promised a sum of money far in excess of that which he has paid as premium. In other words there is a disproportion in the contract of exchange of money with money, which leads to *riba'*. From the *Shari'ah* perspective, exchange contracts (*'uqud al mu'awadat*) in itself are not a problem. In fact, even exchanging money with money is not a problem so

²⁵ The first injunction only reminds people that interest does not add anything to individual or national wealth but decreases it. (*Ar-Ruum*:39). The second commandment forbid Muslim to take compound interest (usury) if they want real and lasting happiness, peace of mind and success in life (*Ali 'Imran*:129). As some people were mixing trade with interest and did not find much difference between the two, the Holy Quran warns them of the evil consequences of this attitude and admonishes them to abstain from this evil practice (*Al-Baqarah*:275-276). Then came the final commandment of Allah, prohibiting interest and declaring it unlawful in our Islamic society. (*Al-Baqarah*:278)

long as there is no difference in the amount and it is done on the spot. The problem with the insurance transaction however, is that the amount of premium and claim (both in terms of money) being exchanged differ in amount and takes place at different times. This brings about the problem of *riba' al-fadl* and *riba nasi'ah*.

However some scholars, on the contrary, argue that the involvement of insurance companies in interest bearing investments is merely incidental to the main business. Participation in such activities if only incidental, does not render the whole business *haram*. Moreover, using the interest factor in determining the price is not the same as charging or earning interest. This is done to take into consideration a cautious estimate of future profits if the capital is utilized productively so as to keep the price as low as possible.

Another view, which is more radical, concedes that Islam does not forbid *riba'* in insurance because this organization has to be maintained, various obligations to be met and workers to be paid from the excess earnings. According to Prof. Sanhuri, *riba'* in insurance contract is permissible due to its pressing need in the modern life. He said that *riba'* can be classified into three categories; *riba' jahiliyah*, *riba' nasi'ah*, and *riba' fadl*. The first category is forbidden altogether, whereas the other two are also forbidden to the extent that there is no pressing need towards them. If there is a pressing need as in the case of insurance, *riba'* is allowed.²⁶

2.4.3 Element of Uncertainty (*Gharar*) in Insurance

The Arabic word *gharar* means risk, hazard, danger, peril, etc. In business terms it means to undertake anything blindly without sufficient knowledge with regards to the subject matter being contracted, or to risk oneself in a venture not knowing exactly what will be the outcome, or to rush headlong into a peril without regard to the consequences. In all these circumstances, the element of risk is present. According to Ibnu Taimiyah, *gharar* is involved when one

²⁶ al-Sanhuri, 'Abd al-Razzaq Ahmad (1952), *al-Wasit fi Sharh al-Qanun al-Madani al-Jadid*, vol.7. Egypt : Dar al-Nashr li al-Jam'iah al-Misriah, p.1088

does not know what is in store for one at the end of business venture or bargain.

The concept of *gharar* may be divided into two groups. In the first group the element of peril or risk involving doubt, probability and uncertainty is dominant. While in the second group the element of doubt due to the deceit and fraud on the part of one of the parties is paramount.²⁷ The Holy *Qur'an* has explicitly forbidden all business transactions including injustice in any form to any of the parties: it may be in the form of deceit or fraud, or undue advantage or peril leading to uncertainty in the business or any dealing.²⁸ There is also clear prohibitory commandment of the Holy Prophet with regard to fraud or deceit in business transaction.

For the first group (i.e. *gharar* owing to doubt and uncertainty), some famous examples include the sale of fish in water, the sale of bird in the air and the sale of fetus in the womb. In this type of transaction there is no guarantee that the seller can deliver the goods for which he receives payment, for the goods are neither in his possession nor has he complete control over his delivery. While some examples of the second group of *gharar* includes the sale of milk in the udder and *tanajush*.²⁹

Dr. Hashim Kamali in his book "Islamic Commercial Law", divided *gharar* into three categories according to the degree of *gharar* as follows:

1. excessive *gharar* (*al-gharar al-kathir*) – this would render the contract invalid;
2. trifling *gharar* (*al-gharar al-yasir*) – this is tolerated and permissible;
3. average *gharar* (*al-gharar al-mutawassit*) – which falls between the two.

²⁷ Afzalur Rahman, op.cit, p.133

²⁸ Refer to these verses of the Holy *Qur'an*: *Al-An'am*:152, *Al-Muthaffifin*:1-6, *Al-Nisa'*:29-30

²⁹ *Tanajusy* is a kind of fraud in which one would offer high price for some thing without having the intention to buy but merely to cheat somebody else who really wanted to buy. Such a person would apparently agree with the seller to buy the thing at a high price in the presence of the actual buyer in order to cheat him.

In their evaluation of *gharar*, whether excessive or trifling, the jurists have been influenced by the prevailing circumstances, popular custom and their own vision and interpretation of public good or *maslahah*. Thus, scholars are divided on the magnitude of *gharar* that is tolerable and unacceptable. Some of the scholars like Ibnu Taimiyah concedes that excessive or unacceptable *gharar* is the one that leads to unlawful devouring of the property of others (*akl al-mal al-ghayr bi al-batil*) which also leads to gambling.³⁰ However some of them do not recognize the difference between excessive and trifling *gharar* as the Holy Prophet has not made such classification. Therefore, any transaction that contains *gharar* is unlawful, irrespective of the degree or magnitude of *gharar*.

As far as conventional insurance is concerned, many *Ulama`* or Muslim jurists have concluded that it does contain an element of *gharar*. Below are some of the arguments to support their views:

1. The subject-matter of insurance contract (i.e. security) is intangible and indeterminate, thus makes the contract null and void under the Islamic law.³¹
2. In spite of tremendous improvement in the techniques and method of calculation of the degree of risk, the element of *gharar* cannot be eliminated though it may slightly reduced. So long as risk and other variables remain indeterminate and merely probable, the amount of premium will contain an element of *gharar*.

³⁰ According to Mohd. Sahri Abd. Rahman in his book "*The Gharar Sale in Share Trading*", *maysir* or *al-qimar* have the element of uncertainty and thus it is *gharar*. But not all *gharar* are *maysir* or *al-qimar*. The difference is that *gharar* is a general term referring to all forms of uncertainty, but *qimar* refers to specific activity that is based on luck

³¹ According Dr. Muhammad Muslehuddin, contract of sales with regard to the subject matter are of four kinds, namely: (1) *bay`* or sale of property, when a determinate article is sold for a price; (2) *muqayada* or barter, that is when a determinate article is sold for another determinate article; (3) *sarf*, that is sale of monetary value for monetary value; and (4) *salam*, that is sale of monetary value for a determinate thing. Commercial insurance is thus categorized as *sarf*. As a contract of sales, insurance contract must fulfill the principles and conditions of a sales contract which include (1) Legal fitness of the persons entering into it (legal capacity); (2) Fitness of the subject matter (*mahal al-aqd*); and (3) Consent of both contracting parties.

3. A contract of insurance is made on risk in the sense that both parties to the contract are ignorant of the degree or the limit of their obligations and responsibilities to each other.³²
4. What constitutes an insurable interest from the in the eyes of the law is very difficult to determine. Moreover, the very nature of the of insurable interest demands that it should be accidental from the viewpoint of the insurer. As such the element of *gharar* is unavoidable.
5. Some element of fraud is quite obvious in commercial insurance as the general public is completely unaware of its terms and conditions. Most of the people are just drawn into it by clever agents and are quite ignorant of the consequences of their insurance policy, especially life insurance.

Despite these arguments from the opponents of commercial insurance, the supporters, on the other hand give their contrary views pertaining to the matter. Their views are summarized below:

1. Uncertainty of subject matter is no bar to the incorporation into Islam of the contract of insurance because *kafala* (bailment or suretyship) is lawful whether the extent of property is known or uncertain.³³
2. Since some uncertainty is inevitable in transactions in the modern world, it may be concluded that the sayings of Prophet pertain to the prohibition of uncertainty in business transactions is confined to the extreme cases such as in gambling. In this light, insurance is far from uncertainty, especially when accompanied by a definite compensation which is the security the insured feels in return for his installments³⁴

³² The insurer does not know the limit of his commitments or the happening of the peril, nor does he know how and when the peril will occur. Likewise, the insured does not know how much and how long he will have to pay his premium installments nor does he know the quantity of his gains on the happening of a peril.

³³ *Kafala* (bailment or suretyship) is a contract of indemnity in Islam. The word *kafala* is derived from the word *al-kifl* which means junction or addition. In the language of law it signifies the junction of one person to another in relation to a claim. The *kafala* is so named because it implies the adding by one person of his responsibility to that of another in respect of demand for something. The supporters of commercial insurance argue that *kafala* is similar to insurance in the sense that both are contract of indemnity.

³⁴ Muhammad Muslehuddin, op.cit. p.144

3. Through insurance, the individuals or organizations can exchange their uncertainty of financial loss (or risk) for the certainty of the premium. With a fixed premium, the insured is certain that he will not have to pay more for that year.
4. The fact that insurance companies relying on the law of great numbers can protect the risks and assess accurately their possible commitments. Their highly trained underwriter and rate makers provide almost faultless assessment of potential risks and price them with precision.

2.4.2 Element of Gambling (*Maysir*) in Insurance

Gambling or in the Arabic word *maysir*, literally means getting something too easily without hard labor, or receiving a profit without working for it. The principle on which the objection is based is that even if there is no fraud, one gains what he has not earned, or loses on a mere chance. Dice and wagering are rightly held to fall within the definition of gambling.

All forms of gambling and betting are prohibited in Islam and are considered acts of impiety and abomination. The Holy Messenger prohibited all forms of business in which the monetary gain comes from the mere chance, speculation, betting, raffling and conjecture and not from work. Any business transaction that contains any of these elements is null and void. For example the Holy prophet specifically forbade such contracts as *Bay` al-Hassat*, *Bay` al-Munabadha*, *Bay` al-Mulamasah* and *Habal al-Habalah* as the outcome of these contract relied purely on chance. This evil was gradually eliminated from society as this evil was also deeply rooted in the economic and social life of the community.³⁵

A study of the history of British Insurance shows that commercial insurance is in no way different from gambling. The Assurance Acts of the eighteenth and

³⁵ The first commandment simply referred to its evils and pointed out that its evil was greater than its profit (*Al-Baqarah*:219). The next and final step was to prohibit this practice altogether (*Al-Maidah*:90)

nineteenth centuries were completely loss in the intricacies of indemnity and insurable interest and consequently, failed to solve the fundamental problem of wagering or gambling. These Acts neither prohibited nor made illegal the existing forms of gambling or wagering, but merely made them null and void; whereas all contracts, including insurance, gambling or wagering, if in conformity with the Common Law principle, had been quite legal and lawful in Britain since the Middle Ages.³⁶

If one compares insurance with gambling he will find a close resemblance between the two as given below:

1. In both, the amount betted (or insured) is paid back to the better (or Insured) when certain events have taken place;
2. In the case of the non-occurrence of an event, nothing is paid back to better (or insured);
3. How the bet or stake in case of betting (and peril in case of commercial insurance) will actually occur and who will be the winner, the better in case of betting (and the insured in case of commercial insurance) or the house (or the insurance company) is anybody's guess;
4. The premium money in commercial insurance is exactly like the stake in betting as far as legal commitments are concerned;
5. The gain of the house in betting and the company in insurance is always certain, while the gain of the better or the insured is doubtful; he may gain or lose;
6. On the whole, the house against all gamblers, and the commercial insurance company against all the insured, are always the winner.

Nevertheless these statements have been argued by some scholars and insisted that insurance has nothing to do with gambling, therefore it is valid and lawful like any other business. Their arguments are summarized below:

³⁶ Afzalur Rahman, *op.cit.*, pp.88-107

1. The insurance contract is reciprocal in the sense that the insurer will not pay the indemnity if the insured does not keep his part of the contract, i.e. pay the premium installment;
2. In gambling one is willing to hand over money out of greed with the possibility of getting more money, or nothing, whereas in insurance one does not wish to waste one's money but is trying to safeguard one's interest against future peril. In gambling one may either lose all or earn huge amounts, but in insurance this is not the case. One is insured against certain kinds of peril and the question of loss does not arise.
3. The money won by a gambler increases his wealth, whereas the amount that the insured gets only provides relief from the burden of loss (indemnity) and should not increase his wealth;
4. The gambler hopes that the event he bets against will occur, whereas when the insured buys the insurance, he does not wish for the event he insures against to occur. He merely buys the insurance as a precautionary measure only;
5. Winnings are paid to a few lucky gamblers. On the other hand, compensations are paid to a few unlucky insureds;
6. The real difference lies in their purpose and in their consequences. Insurance aims at neutralizing and offsetting already existing chances and their consequences, whereas gambling specially and purposely created new ones.

In conclusion, there is no consensus among Muslim jurists regarding the validity of conventional insurance. However, there are several verdicts or *fatwas* released by authorized bodies which can be taken as a guideline for the above matter. For example in 1972 Malaysian National *Fatwa* Council issued a verdict that insurance, especially life insurance, was a corrupt practice as it contained elements of uncertainty (*gharar*), gambling (*maysir*) and interest (*riba*). Several State Religious Councils such as Selangor Negeri Sembilan, Perak, Terengganu and Kelantan have also issued the same verdict³⁷. In Desember 1985, the Council of Islamic Jurisprudence Academy

³⁷ Ma'sum Billah, op.cit, p,354

which embraces Muslim scholars from all over the world has given an endorsement that insurance contract as broadly practiced, is opposite the lawful contract.³⁸

Although some contemporary scholars are trying to review this ruling, with the intention to rectify the alleged misconceptions of past 'Ulama', there is no doubt that conventional insurance as practiced today, contains some or at least one objectionable element. This is true especially when conventional contract of insurance is regarded as a contract of sale, whereby the insurer promises to compensate the insured in exchange for the premium paid. Thus, one cannot say that conventional insurance is 100 percent lawful from the perspective of *Shari'ah*. To bring insurance in line with Islamic principles, Dr. Yusuf Qaradawi suggests in his book "The Lawful and The Prohibited in Islam" that certain modification be made to the insurance contract:

"In my view insurance against hazards can be modified in a manner which would bring it closer to the Islamic principles by means of a contract of donation with a condition of compensation.... Such a type of transaction is allowed in some Islamic school of jurisprudence. If such a modification is effected, and if the company is free of usurious business, one may declare insurance against hazards to be a lawful contract. However, as far as life insurance is concerned, I see it as being remote from Islamic business transactions"

Based on the contract of donation or in Arabic term *tabarru'*, the important aspects of the *takaful* operations are as follows:

1. The company is not the one assuming the risk. Rather it is the various participants who are mutually covering each other;
2. The company is acting as trustee on behalf of the participants to manage the operation of the *takaful* business;

³⁸ Mohd. Fadzli Yusof, op.cit, p.11

3. All contributions paid by the participants will be accumulated in the *Takaful* Fund. All payments of the *takaful* benefits, i.e. claims, will be paid from this fund. At the same time, money credited to the fund can be invested in areas approved by the *Shari'ah*.
4. Should there any surplus from the operation, the company will share the surplus with the participants according to principle of *mudharabah*.

2.5 Types of Insurance and Takaful Business

There are two types of insurance business in Malaysia namely life and general insurance. Life insurance deals with protection against economic loss arising from death. As the loss from death and the capacity and circumstances of individuals to insure their lives varies, life insurance companies have designed various policies to meet the needs of people for protection. There are basically three kinds of life insurance, namely term insurance, whole life insurance and endowment insurance.³⁹ In Malaysia, all life insurance companies are members of Life Insurance Association of Malaysia (LIAM).

On the other hand, general insurance deals with protection against economic loss arising from other factors than death. There are various kinds of this type of insurance which include motor insurance, fire insurance, marine insurance, aviation insurance, engineering insurance and so on. Similar to life insurance companies, general insurance companies are also members of General Insurance Association of Malaysia (PIAM).

In the same way, *takaful* business can also be divided into two types namely family *takaful* and general *takaful*. Under the family *takaful* business, various types of family *takaful* plan are offered which generally are long term *al-mudharabah* contracts. Basically, the plan provides cover of mutual aid among its members or participants expressed in the form of financial benefits paid from a defined fund should any of its members be inflicted by a tragedy.

³⁹ Tang Kin Wah, op.cit, p.5

General *takaful* schemes, on the other hand, are basically contracts of joint guarantee, on a short term basis, based on the principle of *al-mudharabah*. The schemes provide protection in the form of mutual financial help to compensate its members or participants for any material loss, damage or destruction that any of them might suffer arising from a catastrophe, disaster or misfortune that might inflict upon his properties or belonging. The schemes include motor *takaful*, fire *takaful*, engineering *takaful*, marine *takaful* and so on.⁴⁰

2.6 Conclusion

In conclusion, Islam is not against the concept of insurance. In fact, insurance that is aimed at helping someone in the happening of loss or disaster is well accepted by Islam and the Holy Prophet. To be certain, the teachings of Islam, call for the protection of certain basic rights which include life and property. Furthermore, it encourages the act of mutual help and responsibility

Nonetheless, how the system operates (i.e. the means and methods) should be scrutinized first before accepting it. Islam has delineated that each institution, transaction, or obligation is to be measured by the standard of religious and moral rules such as the prohibition of *riba*, *maysir* and *gharar*. In conjunction with this, most of the Muslim jurists have found that commercial insurance as widely practiced nowadays is invalid due to its involvement with such prohibited elements.

Therefore, an insurance system which is based on the concepts of *takaful*, *tabarru'* and *mudharabah* was introduced by Muslim scholars as an alternative to the conventional insurance. Such system resembles the true principles of mutuality and cooperation. At the same time, this system fulfils the human need for security without violating the *Shari'ah* guidelines.

⁴⁰ BIRT, *Takaful, Concept and Operational System From the Practitioner's Perspective*, Kuala Lumpur : BIRT, p.11