CHAPTER – II

CONCEPTUAL FRAMEWORK OF INSURANCE

A. UNDER COMMON LEGAL SYSTEM
B. UNDER ISLAMIC LEGAL SYSTEM
Chapter-II

CONCEPTUAL FRAMEWORK OF INSURANCE

A. Under Common Legal System

The uncertainties of human life, the dangers and pitfalls with which it is surrounded and the risks accompanying the dealings of human creatures intense may be said to be the cause of the beginning and development of insurance in all its departments. The essence of all insurances is the transfer of such risks and dangers to the shoulders of the persons who are willing to accept the burden for money consideration.

For example: The time of death of a person is not certain and in the case of his premature death, a man's dependents may find themselves deprived of all means of existence. Therefore, the basic purpose of insurance is to minimize the hard effects of such happenings by providing a consolidated amount for the substance of the dependants of the deceased person, in consideration of timely payment by him during his lifetime. Likewise, the property of a person is open to all risks of its being destroyed by fire, flood or by any other unforeseen natural calamities and in this case, insurance steps are to indemnify the owner of the property in cases aforesaid. The consideration in such a case is again the timely payment of installments by the owner. It is obvious that insurance is necessarily based on pecuniary considerations and only that risk which is measurable in terms of money can be the basis of a contract of insurance.¹

RATIONAL BEHIND INSURANCE

The rational behind insurance is to provide security against financial catastrophe, by the undertaking to indemnify the insured against loss or damage. Insurance is a device to replace the uncertainty of a possible large

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economic loss by the certainty of a small loss i.e. the premium. Reduction of loss or risk fosters security, which permits better management and planning’s in life and the business. This will lead to better resources resulting in the increase of productivity. Therefore, insurance helps in reducing the risk and provides security to the public at large.

MEANING OF INSURANCE

Insurance is a method, which provides security and protection against financial losses. It is a tool by which group of small number of people are compensated out of the funds collected in forms of premium from large number of people. Therefore, it is a means of shifting the risks to insurer in consideration of a nominal price called premium. The Risk may be transferred in two ways:

Firstly, A person may transfer the activity or avoid such events which creates the risk.

Secondly, by entering into a contract a person shifts responsibility for any loss resulting to the occurrence of specified uncertain event to the other person who is party to the contract. It is one of the most important forms of risk transfer in insurance sector now a days. Hence, insurance is a safeguard against uncertainties.

Following illustrations make clear the above-stated notion of insurance.

Illustration 1:

In a city, there are 2000 persons who are all aged 50 and are healthy. It is expected that of these 20 persons may die during the year. If the economic

value of the loss suffered by the family of each dying person were taken to be Rs. 50,000. The total loss would work out to Rs. 10,00,000. If each person of the group contributes Rs. 500 per year, the common fund would be Rs. 10,00,000. This would be enough to pay Rs. 50,000 to the family of each of the 20 dying persons. Thus, the risks in case of 20 persons are shared by 2000 persons.

Illustration 2

In a village, there are 250 houses, each valued at Rs. 2,00,000. Every year one house gets burnt, resulting into a total loss of 2,00,000. If all the 250 owners came together and contributes Rs. 800 each, the common fund would be Rs. 2,00,000. This is enough to pay Rs. 2,00,000 to the owner whose house got burnt. Thus, the risk of one owner is spread over 250 house owners of the village.

Different definitions are given by different persons on the subject of insurance. Some definitions are based on principle and some are based on practice. So, definitions of insurance are classified into two ways:

a) Functional Definition

b) Legal Definition

Functional Definitions

1. “Insurance is a process in which uncertainties are made certain.”
   MacGill

2. “Insurance is a plan wherein persons collectively share the losses of risks.”
   John Megi

3. “Insurance is a source of distribution of loss of few persons into many persons.”
   Rock fell

4. “The function of insurance is primarily to decrease the uncertainty of events.”
   Reigel and Mille

5. “The collective bearing of risk is insurance.”
   William Beveridge
6. "Insurance is a plan by which large number of people associate themselves and transfer, to the shoulders of all, risks attached to individuals."

D.H. Mage

7. "Insurance is a provision which a prudent man makes against fortuitous or inevitable contingencies, loss or misfortunes. It is a form of spreading risks."

Thomson

8. "Insurance is a co-operative device to spread loss caused by a particular risk over a number of persons who are exposed to it, who agrees to insure themselves against that risk."

Prof R.S. Sharma

9. "Insurance is an instrument of distributing the loss of few among many."

W.A. Disnadle

10. "Insurance is a contract by which one Party for a compensation called in the premium assumes particular risk of the other party and promises to pay to him or his nominee a certain or ascertainable sum of money on a specified contingency."

E.W. Fitterson

11. "Insurance is a device for the transfer to an insurer of certain risks of economic loss that would otherwise be borne by the insured."

Allen L. Mayerson

On the basis of above functional definitions, we may conclude that:

a) Insurance is a co-operative device by which risks are distributed among large number of persons.

b) Insurance provides security against losses or risks.

c) Based on the law of probability, contribution of each person is calculated and a common fund is raised out of which losses are compensated.

d) Insurance is a plan in which losses of uncertain events are secured.

Legal Definitions

1. "Insurance is a contract in which sum of money is paid by the assured in consideration of the insurer's incurring the risk of paying a large sum upon a given contingency."

Chief Justice Tindal
2. According to Per Lawrence J in Lucena vs. Craufurd\(^7\)

A contract of insurance is a contract by which one party in consideration of the adequate price paid to him to the risk becomes security to the other, that he shall not suffer loss, damage or prejudice by the happening of perils specified to certain things, which may be exposed to these.

3. Insurance may be described as a social device where by a large group of individuals through a system of equal contribution may reduce or eliminate certain measurable risks of economic loss common to all members of the group.

Britannica Encyclopaedia

4. Insurance is a form of contract or agreement under which one party agrees in return for a consideration to pay an agreed amount of money to another party to make good for a loss, damage, or injury to something of value in which the insured has a pecuniary interest as a result of some uncertain event.

Dictionary of Business and Finance

5. Insurance is the payment of a sum of money by one person to another on the understanding that in specified circumstances the second person will make good any loss suffered by the first.

Dictionary of Commerce

From the above definitions, we can conclude that:

(a) Insurance is a contract whereby

(b) Certain sum, termed as premium, is charged in consideration.

(c) Against the said consideration, a large amount is guaranteed to be paid by the insurer who received the premium.

(d) The compensation will be made in certain definite sum, i.e. the loss or the policy amount whichever may be.

(e) The payment is made only upon a contingency.

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\(^7\) (1802) 3 BOS.
Nature of Insurance

The exact nature of contract of insurance is described by Channel J; in Prudential Insurance Co. Ltd. Vs. Inland Revenue Commissioners. He Observed:

"What is a contact of insurance? The Attorney General says that to make it an insurance it must be an insurance against something and as to that it was said for the appellants that it will be true enough as regards fire and marine but was not true of life policy. One condition required of a contract to be in any sense a contract of insurance. It may be a contract where by for some good consideration, usually but not necessarily a periodical payment, you secure for yourself some benefit usually, but not necessarily the payment of a sum of money upon the happening of some event. What is called insurance against something? The assuring that you will have a sum of money if a particular event happens."

"The next thing is that the event should be one which involves some amount of uncertainty. There must be some uncertainty whether the event will ever happen or if it is an event which must happen there must be an uncertainty as to the time of its happening, that idea appears to me to be involved in the word insurance."

Per Lawrence J. in Lucena Vs. Crafurd observed:

"The general nature of insurance is to protect men against uncertain events which may otherwise be some disadvantage to them not only to those persons, to whom positive loss may arise by such events occasioning the deprivation of that which they may possess, but also those who in consequences of such events may have interpreted from them the advantage or profits which but for such event they will acquire according to the ordinary and probable course of things."

8. (1904) 2 KB 658-73.
Features of Insurance

The following are the features of the insurance as per the need of insurance to the individual as well as society:

1. **Risk Transfer**: Insurance is a process to share the losses that might occur to a person or his family on the happening of a particular event. The event may be death of a person, perils and hazards in voyage, fire, accident and many more other certain events. The loss resulting from these events if insured are shared by the insured in the form of premium. Thus, risk is transferred from one person to a group.\(^{10}\)

2. **Co-operative Tool**: Insurance is a cooperative tool under which a pool of persons willing to share the losses brought together "voluntarily or through agents". An insurer is not able to compensate all the losses by his own money. So, by insuring huge number of persons, he generate the ability to pay the amount of loss. Hence, insurance is a co-operative device.\(^{11}\)

3. **Compensation at the Time of Loss**: This is the hallmark of insurance. That compensation is paid at the time of loss or contingency. If the loss occurs, payment is made. Since the life insurance contract is a contract of certainty, because the contingency the death or the expiry of term, will certainly occur, the payment is certain.

4. **Payment**: On the happening of the contingency, the insurer is legally bound to pay for the loss suffered by the insured. The amount of payment is based upon the value of loss suffered by the insurer on the happening of a specified event. The insurer promises to pay a certain amount on the happening of a specified event, but the amount of loss as well as happening of loss, are required to be proved.

5. **Large Number of Insured Person**: To stretch the benefit of insurance to the large number of people, it is pre-requisite to insure large number of

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10. See Bodla B.S. Gang, M.C. and Singh K.P., op. cit., p. 5.
11. Id.
persons because the lesser would be the cost of insurance and it will lower down the amount of premium.\textsuperscript{12}

**Functions of Insurance**

Insurance performs variety of functions, which are advantageous to the common people directly or indirectly. As such, functions of insurance can be divided into three categories:

a) Primary Functions  
b) Secondary Functions  
c) Indirect Functions or other functions

A) **Primary Function**: The Primary function of insurance is to distribute equally the financial losses of individuals into many people. This is well explained by fire insurance where the policyholders pay premiums into a common fund, out of which those who suffer losses are compensated. Insurance must be offered to the public at large on attractive terms so as to encourage public towards insurance and also provide them reasonable profits.\textsuperscript{13}

B) **Secondary Functions**: The secondary function of insurance is to provide capital to the industry in various forms. It reduces the risks and losses by creating new avenues of capital investments in different organisations; and the sum received in form of premium by different insurance companies is made available for the overall economic development of the country.

Insurance by reducing the risks or fear of losses increases the efficiency of the business. It gives a soothing effect to the business by providing feeling of security, which in turn it leads to the entire developments and growth of the insurance industry.\textsuperscript{14}

\textsuperscript{12} Ibid.  
\textsuperscript{14} See Singh Inderjeet, Katyal Rakesh, Kaur Surjeet, op. cit, p.11.
C) **Indirect or other Functions:**

(i) The large funds collected by insurers are invested, thereby indirectly assisting the Government, public authorities and industry as a whole.

(ii) Insurance transaction on an international basis makes a substantial contribution to the Country's invisible exports.\(^{15}\)

(iii) Insurance encourages capital formation in the society. This helps in investment of insurance.\(^{16}\)

**Parties to Insurance**

The contract of insurance involved two parties: The Insured and the Insurers.

1. **Insured:** This term refers to the party effecting the insurance either through an agent or through broker.\(^{17}\) In other words, the person to whom the undertaking is given and whose interests are to be protected by the policy is called the insured.\(^{18}\)

2. **Insurer:**

   (a) Any individual or unincorporated body of individuals or body of corporate incorporated under the law of any country carrying an insurance business [not being a person specified in sub-clause (c) of this clause] who-

      i. carries on that business in India, or

      ii. has his or its principal business or is domiciled in India, or

      iii. with the object of obtaining insurance business employs a representative, or maintains a place of business in India.

   (b) Any body corporate carrying on the business of insurance, which is a body corporate incorporated under any law for the time being in force in India, or stands to any such body corporate in the relation

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15. See Dinsdale, W.A., op. cit, pp. 6-7.
17. See Dinsdale, W.A., op. cit, p. 4.
of a subsidiary company within the meaning of the Indian Companies Act, 1913, as defined by subsection (2) of section 2 of that Act, and

(c) Any person who in India has a standing contract with underwriters who are members of the society of Lloyd's whereby such person is authorised within the terms of such contract to issue protection notes, cover notes or other documents granting insurance cover to others on behalf of the underwriters.

But does not include a principal agent, chief agent, or an insurance agent or a provident society.19

In other words, insurer refers to the person granting protection to the insured against unspecified loss or damage.

**Essentials of Insurance**

As discussed above that, there are two main parties in an insurance contract, i.e. the insurer and the insured. Insurer is the one who undertakes to pay the sum guaranteed on the happening of an unforeseen event and insured who pays the premiums for insurance protections. The essentials of an insurance contract like any other contracts according to section 10 of the Indian contract Act, 1872 are as follows:20

1. **Offer21 and Acceptance:**22 - For a valid insurance contract there must be an offer from insurer and it must be accepted by the insured; only than an insurance contract can take place23

   It must be noted that acceptance to insurance contract must be absolute and unconditional.24

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19. See The Indian Insurance Act 1938, Section 2(9)
20. See Singh Inderjeet, Katyal Rakesh, Kaur Surjeet, op. cit, p. 17
21. The Indian Contract Act, 1872, section 2(2)
22. Ibid, section 2(b)
24. Ibid Section 7 (i)
2. **Legal Consideration**: For a valid insurance contract, there must be a legal consideration. In the words of Pollock, “Consideration is the price for which the promise of the other is bought and the promise thus given for value is enforceable.”

According to Indian Contract Act, 1872 consideration is defined as follows:

“When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing or promises to do or to abstain from doing, something such act or abstinence or promise is called a consideration for the promise.”

So, insurance is a contract by which one party in a consideration called premium, takes over a particular risk of the other party and promises to pay to the insured or his nominee a certain sum of money on the happening of an unspecified event.

3. **Competency**: The parties to the contract should be competent to contract. Every person in competent to contract:

   a) Who is of the age of majority according to the law.

   b) Who is of sound mind, and

   c) Who is not disqualified from contracting by any law to which he is subject.

A minor is not capable of entering into a contract. A contract by a minor is void except contracts for necessaries. A person is said to be of sound mind for making a contract if at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interest.

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25. See The Indian Contract Act, 1872, Section 10
26. See The Indian contract Act, 1872, Section 2(d).
28. See The Indian Contract Act, 1872, Section 10
29. See The Indian Contract Act, 1872, Section 11
30. See Dr. Bangia, R.K., op. cit, p.18
As far as the insurance contracts are concerned, only those insurers can grant insurance policies that have been issued licenses by Insurance Regulatory and Development Authority (IRDA). Similarly, minor people, people of unsound mind and criminal background persons cannot take on insurance.\textsuperscript{31}

4. **Free Consent:** When both the parties have agreed to a contract on the terms and conditions of the agreement in the same sense and spirits, they are said to have a free consent.\textsuperscript{32} Consent is said to be free when it is not cause by:

a) Coercion
b) Undue influence
c) Fraud
d) Misrepresentation
e) Mistake\textsuperscript{33}

As far as insurance contracts are concerned free consent forms the basis of it.

5. **Legal Object:**

The fifth and the last requirement for the formation of a valid insurance contract is that parties must contract for a lawful object.\textsuperscript{34} The object of the agreement should be lawful.\textsuperscript{35} An object that is:

a) not forbidden by law, or
b) is not immoral, or
c) opposed to public policy, or
d) which does not defeat the provisions of any law, is lawful.\textsuperscript{36}

\textsuperscript{33} See The Indian Contract Act, 1872, Section 14
\textsuperscript{34} See The Indian Contact Act 1872, Section 10
\textsuperscript{35} See Dr. Singh, Avtar, op. cit, p. 199
\textsuperscript{36} See, The Indian Contract Act; 1872, Section 23
In proposal form, the object of insurance is asked which should be legal and the object should not be concealed. If the object of insurance, like the consideration is found to be unlawful, the policy is void.\textsuperscript{37}

\textbf{Principles of Insurance}

As already discussed, the essentials of insurance contract derive their validity from section 10 of Indian Contract Act 1872, and it makes contract of insurance a special type of contract. The Indian Contract Act defines a contract as “All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void”.\textsuperscript{38} As such, insurance is a contract by which insurer for consideration i.e. premium promises to take the risks of the insured and agrees to pay him or his legal nominee a specified sum of money on a contingency or loss.\textsuperscript{39} In this way, insurance contract, in addition to this fulfills the essential requirement of a valid contract i.e. proposal, acceptance, free consent, competency of the parties. Some of the fundamental principles of insurance are as follows:

a) Utmost good faith  
b) Insurable interest  
c) Indemnity  
d) Subrogation  
e) Contribution  
f) Proximate cause  
g) Mitigation of loss, etc.\textsuperscript{40}

Now we shall discuss in detail all these basic principles of insurance:

\textsuperscript{37} See Bodla, B.S., Garg M.C, and Singh, K.P. op. cit, p. 20.  \textsuperscript{38} See Supra Note 37  \textsuperscript{39} See Singh Inderjeet, Katyal Rakesh and Kaur Surjeet, op. cit, p. 91.  \textsuperscript{40} See Gongva, P.P.S., Elements of Mercantile Law, 2nd Edition, Sultan Chand Publishers, New Delhi, 1999, p. 699
1. **Utmost Good Faith:**

The true concept of good faith i.e. uberrimaefidei is given by Lord Blackburn in *Brownlie Vs. Campbell*\(^41\) as:

"In policies of insurance whether Marine Insurance or Life Insurance, there is an understanding that a contract is uberrimaefidei i.e. if you know any circumstance at all that may influence the underwriters opinion as to the risk that he is incurring, and consequently as to whether he will take it or what premium he will charge if he does take it, you will state what you know. There is an obligation to disclose, what you know and the concealment of a material circumstance known to you whether you thought it material or not, avoids the policy. But in other contracts it is not so".

It is fundamental principle of insurance law that the contracting parties must observe utmost good faith. Good faith forbids either party from concealing of what he privately knows, to draw the other into bargain from his ignorance of fact and his believing the contrary.\(^42\) Therefore, both the parties to the contract are required to observe utmost good faith and should disclose every material fact known to them. There is no difference between a contract of insurance and any other contract except that in a contract of insurance there is a requirement of utmost good faith.\(^43\) The burden of proof to show non-disclosure or misrepresentation is on the insurance company\(^44\) and this is a heavy one.\(^45\) The duty of good faith is of a continuing nature in as much no material alteration can be made to the terms of the contract without the mutual consent of the parties.\(^46\) Just as the assured has a duty to disclose

\(^{41}\) (1880) 5 A.C. 925.

\(^{42}\) See United India Insurance Company Ltd. Vs. MKJ Corporation, AIR (1998), 92 Comp Cases 331 (333).


\(^{44}\) See Life Insurance Corporation of India vs. Smt. GM Chamabasama, AIR(1991) ,1 SCC 357.

\(^{45}\) See Life Insurance Corporation of India vs. Parvathavardhini Annual, AIR (1965), Med 357.

\(^{46}\) See United India Insurance Co. Ltd, Vs. MKJ Corporation, AIR (1996) SCC 428.
all the material facts, the insurer is also under an obligation to do the same. The insurer cannot subsequently demand additional premium nor can he escape liability by contending that the situation does not warrant the insurance cover. Recently Supreme Court of India in P.C Chacko Vs Chairman, Life Insurance Corporation of India, held that from the very fact that the contract of insurance involves a risk and it purports to shift the risk from one party to the other, each one is required to be absolutely innocent of every circumstance which goes to influence the judgment of the other while entering into the transaction.

**Legal Basis of Utmost Good Faith**

In the leading English case Lord Mansfield stated the basis for the principle of utmost good faith as:

"Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the underwriters trust to his representation and proceeds upon the confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstances does not exist, and to induce him to estimate the risk as if it did not exist"  

The Apex Court in the case of Hand Era Textile Ltd. vs. Oriental Insurance Co. Ltd. has stated that:  

"The contract of the insurance, like other contracts of insurance, differs from any ordinary contract in that it requires, throughout its existence, the utmost good faith to be observed on the part of both the insured and the insurers."

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47. See The Indian Marine insurance Act, 1906, Section 21(a) See LIC of India vs. Asha Goel, AIR (2001) SCC 160.  
49. See United India Insurance Co. Ltd. vs. MKJ Corporation, (1996) 6 SCC 428.  
52. AIR (2001) 1 SCC 269.
The Karnataka High Court in National Insurance Company Ltd. vs. Mirza Govinda Arrappa Pai and Son's\(^5^3\) states the basis of utmost good faith as:

"that the contract of insurance being a contract uberrimaefides based on utmost good faith when the consignor himself has not acted in a prudent manner so as to further the trust, which the insurance company had in the transaction it cannot be saddled with the responsibility."

**Extent of Inherent Duty of Good Faith**

Sections 19, 20 and 21 of the Indian Marine Insurance Act, 1963 provide a clear indication as to the effect of non-observance of utmost good faith, what facts the assured should disclose, or need not disclose etc. in a contract of marine insurance. These may be taken as applying Mutatis Mutandis (with necessary changes) to all classes of insurance.\(^5^4\)

**Insurance is Uberrimaefidei\(^5^5\)**

A contract of Marine insurance is a contract based upon utmost good faith and, if that be not observed by either party, the contract may be avoided by the other party.

**Disclosure by assured\(^5^6\)**

1) Subject to the provisions of this section the assured must disclose to the insurer, before the contract is concluded every material circumstance which is known to the assured, and the assured is deemed to know, every circumstance which in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract.

2) Every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium, or determining whether he will take the risk.

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55. See Indian Marine Insurance Act, 1963, Section 19
56. Ibid, Section 20
3) In the absence of inquiry the following circumstance need not be disclosed, namely:

a) Any circumstance which diminishes the risk;

b) Any circumstance which is known or presumed to be known to the insurer. The insurer is presumed to know matters of common notoriety or knowledge and matters which an insurer in the ordinary course of his business, as such, ought to know;

c) Any circumstance to which information is waived by the insurer;

d) Any circumstance which it is superfluous to disclose by reason of any express or implied warranty.

4) Whether any particular circumstance, which is not disclosed, be material or not, is in each case, a question of fact.

5) The term circumstance includes any communication made to, or information received by, he assured.

**Disclosure by Agent effecting Insurance**

Subject to the provisions of the preceding section as to circumstances which need not be disclosed, where an insurance is effected for the assured by an agent, the agent must disclose to the insurer:

a) every material circumstance which is known to him, and an agent to insure is deemed to know every circumstance which in the ordinary course of business ought to be known by, or to have been communicated to him; and

b) every material circumstance which the assured is bound to disclose, unless it comes to his knowledge too late to communicate it to the agent.

**Illustration**

X made a proposal to Y an insurance company, for an insurance policy on his life for Rs. 500,000. On the proposal form, he truthfully answered all the questions and disclosed all the material facts. After a few days, but before the acceptance of the proposal by the insurance company, X seriously fell ill. But this fact was not disclosed to the insurance company. The proposal was accepted by the company the next day. And two days thereafter, X died due to

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57. Ibid, Section 21
his illness. The insurance company came to know about X's illness for the first time only on his death, in a claim on the policy. In this case the insurance company was not liable to pay the claim. Thus, due to X's illness there was material alteration in the risk between the date of the proposal and its acceptance, and the notice of the same was not given to the company. Thus, there was a breach of good faith.

2. Insurable Interest

Insurable interest is a basic essential of any contract of insurance. At a general level, this means that the party to the insurance contract who is the insured or policy holder must have a particular relationship with the subject matter of the insurance, whether that be a life or property or a liability to which he might be exposed. The absence of the required relationship will render the contract illegal, void or unenforceable depending upon the type of insurance.58

Lawrence, J. has given definition of insurable interest in Lucena vs. Craufurd as follows-

"A man is interested in a thing to whom advantage may arise or prejudice may happen from the circumstances which may attend it.... And whom it importeth that its condition as to safety and other quality should continue. To be interested in the preservation of a thing, is to be so circumstanced with respect to it as to have benefit from its existence, prejudice from its destruction."

According to Patterson, insurable interest is a relation between the insured and the event insured against, so that the occurrence of the event would result in substantial loss or injury of some kind to the insured.60

Section 7 of the Marine Insurance Act, 1963 defines insurable interest as:

59. (1806) 2 BOS & PNR 269.
Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure.  

In particular, a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein. In consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss or by damage thereto or by the destruction thereof or may incur liability in respect thereof.

So, insurable interest may be defined as a pecuniary interest in the subject matter of insurance.

To constitute insurable interest, it must be an interest whereby the risk would by its proximate effect cause damage to the assured, that is to say, cause him to lose a benefit or incur a liability. The validity of an insurance contract, in India, is dependent on the existence of an insurable interest in the subject matter. The person seeking an insurance policy must establish some kind of interest in the life or property to be insured, in the absence of which, the insurance policy would amount to a wager and consequently void in nature.

The test for determining if there is an insurable interest whether the insured will in case of damage to the life or property being insured, suffer pecuniary loss. A person having a limited interest can also insure such interest.

Insurable interest varies according to the nature of the insurance. The controversy as to the existence of an insurable interest between spouses was settled by the court, which held that such an interest could

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62. Id.
63. See Seagrave vs. Union Insurance Company Ltd. (1886) LR 1 CP 305.
64. See Ancil vs. Manufacturer's Life Insurance Company (1899) AC 604 (PC).
66. See Tomilson (Haulters) Ltd. vs. Hoplurane, 1966 (1) AC 418.
exist as neither was likely to indulge in any mischievous game. The same analogy may be extended to parents and children.

**Time when Insurable Interest Must Exist**

In life and personal accident insurance, it is enough if insurable interest exists at the time policy is effected. In fire and motor insurances, it must exist both at the inception of the contract and at the time of loss. In marine insurance it must exist at the time of the loss, though not when the insurance is effected. When the contract is entered into, the insured must at least have an exception of acquiring such an interest.

In view of definition of “an adventure analogous to a marine adventure” in section 4 (2) of the Marine Insurance Act, 1963, corresponding to section 135-A of the Transfer of Property Act, 1882, existence of interest apply to cases where the goods or movables are exposed to perils incidental to local or inland transit.

**Illustration:**

P borrowed Rs. 2,00,000 from Q, a money-lender and mortgaged his house with him, Q as security for the repayment of loan. In this case, both P and Q have insurable interest in the house, and may insure the same in order to protect their respective interest.

3. **Indemnity**

The term indemnity may be defined as the security against the loss. The object of contract of insurance is to make good the loss suffered by the insured person i.e. to place the insured person as nearly as possible in the same position in which he was immediately before the happening of the event against which he was insured. Thus, every contract of insurance except, life

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67. See Griffith vs. Fleming (1909) 1 K.B. 805.
68. See Dalby vs. India and London Insurance (1854) 15 CP 365
70. See Gaya Muzaffar pur Roadways Comp. vs. Fort Gloster Industries Ltd., AIR 1971 Cal. 494 (503).
insurance and personal accident insurance is a contract of indemnity.\textsuperscript{71} This means that it is not a contract to make a gain. It is to leave him neither a loser nor a gainer subject to his insuring the property for its full value.\textsuperscript{72} In \textit{Castellian vs. Preston}\textsuperscript{73} Brett LJ explained that: “Every contract of marine, fire insurance is a contract of indemnity and of indemnity only, the meaning of which is that the insured person in case of a loss is to receive a full indemnity but is never to receive more. Every rule of insurance law is adopted in order to carry out this fundamental rule.\textsuperscript{74} The principle of indemnity which means that the insured can in no event make a gain out of that transaction is a salutary rule of law to keep in check a human weakness. The insured will otherwise be tempted to destroy the property himself or connive at its destruction and claim the sum insured.” An insurance against fire or riot is a contract of indemnity and the undertaking by the insurer is that, if the insured suffers any loss\textsuperscript{75} in respect of the insured property, the insurer will indemnify the insured to the extent of the actual loss, the maximum limit of indemnity being the sum mentioned in the insurance contract.\textsuperscript{76}

Indemnity is such a fundamental principle of insurance that the doctrine of subrogation and contribution are corollaries of this principle to further ensure that the insured does not make any profit out of the insurance transaction.\textsuperscript{76}

Although the principle of indemnity puts the insured person in the same position as if the loss has not occurred, the amount of indemnity may be limited by certain conditions:

\begin{itemize}
\item[a)] Injury or loss sustained by the insured has to be proved.
\item[b)] The indemnity is limited to the amount specified in the policy
\item[c)] The insured is indemnified only for the proximate causes.
\end{itemize}

\begin{footnotes}
\item[71.] See Gogna, PPS, op. cit., pp. 700-701.
\item[72.] See Srinivasan, MN, op. cit., p. 385.
\item[73.] (1883) 1 Q & A 380.
\item[74.] See M Venkatachalapathy vs. United India Insurance Comp. Ltd. III, AIR (2005) ACC 640, Union of India vs. Sri Sardar Mills Ltd., AIR (1973) SC 281.
\item[75.] See Life Insurance Corporation of India vs. Firm Tirath Ram and Sons and others, AIR (1966) 36 Company cases (105).
\item[76.] See Varia Silk Mills vs. CIT, AIR (1991) SC 2104.
\end{footnotes}
d) The market value of the property determines the amount of indemnity.\textsuperscript{77}

**Illustration:**

Ram insured his house against fire with Khan Pvt. Ltd., an insurance company. The house was insured for Rs. 5,00,000. Afterwards, the house was destroyed by fire, and it was estimated that it would be restored to its original condition by spending Rs.1,00,000. In this case Ram can recover Rs.1,00,000 from the Khan Insurance Company as the actual loss suffered by him is Rs.1,00,000 only.

4. **Subrogation**

Subrogation means the substitution of the insurance company in place of the assured in respect of all the rights and remedies, which the assured has against the third party. Therefore, if the insured person recovers the full extent of the loss from the insurance company, then the insurance company gets the rights and remedies of the assured and can proceed against the third party for the recovery of compensation. And if the insured person also receives the compensation from the third party in respect of the same loss, then he must pay over that amount to the insurance company.\textsuperscript{78}

The doctrine of subrogation confers upon the insurer the right to receive the benefit of such rights and remedies as the assured has against third parties in regard to the loss to the extent that the insurer has indemnified the loss and made it good. The insurer is therefore, entitled to exercise whatever rights the assured possesses to recover to that extent compensation for the loss, but it must do so in the name of the assured.\textsuperscript{79}

Subrogation by act of law would not give the insurer a right to serve in a court of law in his own name. Subrogation is concerned solely with the mutual rights and liabilities of the parties to the contract of insurance. It confers no right and imposes no liabilities upon third parties. They are

\textsuperscript{78} See Gongva, PPS, op. cit.p. 702.
\textsuperscript{79} See Oberai Forwarding Agency vs. New India Assurance, AIR 2000, SC 855.
strangers to the contract and the insurer who had paid the loss gets no refund or remedy against anyone. Thus, the assured only can serve such parties in his own name.80

The doctrine of subrogation confers two specific rights on the insurer.

Firstly, the insurer is entitled to all the remedies which the insured has against the third party incidental to the subject matter of the loss, such that the insurer can take advantage of any means available to extinguish or diminish, the loss for which the insurer has indemnified the insured.

Secondly, the insurer is entitled to the benefits received by the assured from the third party with a view to compensate himself for the loss.81

The fact that an insurer is subrogated to the rights and remedies of the insured does not ipso jure enable him to sue third parties in his own name.82 It will only entitle the insurer to sue in the name of insured, it being an obligation of the insured to lend his name and assistance to such an action.83

**When does Right of Subrogation Arise**

The right of subrogation only arises when the policy is a valid contract of insurance. There is no room for the application of subrogation where the so-called insurance is a mere wager and is void as such.84 In order to bring in to existence the insurer's right of subrogation, it is necessary that the claim of the insured under the policy be actually paid to him;85 and it arises upon the payment of a partial as well as upon the payment of total loss.86

The insurer has no right of subrogation in cases where the insured property is destroyed by the acts for which the assured would have been responsible in law if the property had not been his own, for the insurer takes

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81. See Castellan vs. Preston, (1881), All ER 494.
82. See UOI vs. Sri Sarda Mills Ltd, Supra Note 83
83. See Vasudeva Mudaliar vs. Caledonian Insurance Company & Another, AIR 1965 Mad 159.
84. See Edward and Co. vs. Motor Union Assurance Co. (1922) 2 K.B. 249.
85. See Midland Insurance Co. vs. Smith (1881) 6 Q.B.D. 561.
86. See Simpson vs. Thomson (1877) 3 A.C. 279.
the risk of the negligence, if not wilful, as part of the risk against which they insure.\(^{87}\)

**Illustration:**

Rahim insured his factory against fire with Shayam Pvt. Ltd., an insurance company. The factory was damaged by fire which was caused by Manmeet, a miscreant. The insurance company compensated Raheem for the full loss suffered by him. Now, the insurance company can proceed against Manmeet as it acquires all those rights which are available to Raheem against Manmeet.

5. **Contribution**

According to Federation of Insurance Institute, Bombay, contribution may be defined as the right of an insurer who has paid a loss under a policy to cover a proportionate amount from other insurers who are liable for the loss.

When a person gets a subject matter insured with more than one insurer called the “Double Insurance” whereby in the event of damage, he cannot claim anything more than the total loss from all the insurers together. Under the principles of indemnity, the insured cannot be restored to a better position than before the loss. In such cases the total loss suffered by the assured is contributed by different insurers in the ratio of the value of policies issued by them for the same subject matter.\(^{88}\)

**Conditions for Contribution**

a) The insured must be the same person in all the insurance policies.

b) The occasion insured against must be the same in all the insurance policies.

c) The subject matter of the insurance must be common in all the insurance policies.

d) The insurance policies must be with the different companies and all policies must be in force at time of loss or damage.

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87. Id.
88. See Singh Inderjeet, Katyal Rakesh & Kaur Surjeet, op. cit., p. 113.
e) One of the insurance companies must have paid to the insured person more the share of its loss. 89
f) When that insurer has discharged his liability, he is entitled to call upon the other insurers of the same risk to contribute their share of the loss. 90

The right of contribution is based not in contract but on what has been said to be the plainest equity that burdens should be shared equally. It would be inequitable for any of the insurers to receive the benefit of the premium without being liable for their share of loss. 91

The liability of an individual insurance company under the principle of contribution is determined by applying the following formula:

\[
\frac{\text{Sum insured by the insurer}}{\text{Total sum insured}} \times \text{loss}
\]

Illustration:

Suppose Mr. Mohan insured his residential house against the risk with three insurers in the following manner:

<table>
<thead>
<tr>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sum insured with insurer - A = 1,00,000</td>
</tr>
<tr>
<td>Sum insured with insurer - B = 1,00,000</td>
</tr>
<tr>
<td>Sum insured with insurer - C = 1,00,000</td>
</tr>
<tr>
<td>Total sum insured = 3,00,000</td>
</tr>
</tbody>
</table>

The property is destroyed in fire and the loss is estimated Rs.60,000. Now, the insured Mr. Mohan wants to get claim from insurer, C. There arises the problem of valuing proportionate recoveries from the other insurer i.e. A & B. In such cases, the insured is obliged to prefer to get claims from all the insurer, each of whom shall pay only his proportion of the loss calculated in the following manner:

89. See Gongva, PPS, op. cit., p. 703.
90. See Weddell vs. Road Transport and General Insurance, (1931), All ER Rep 609, 611.
Proportion of a particular insurer:

\[
\frac{\text{Sum insured by the insurer}}{\text{Total sum insured}} \times \text{loss}
\]

Thus, in the above problem the loss of Rs.60,000 shall be compensated by all insurers as calculated below:

**Contribution of insurer A:**

\[
= \frac{1,00,000}{3,00,000} \times 60,000 = \text{Rs. 20,000}
\]

**Contribution of insurer B:**

\[
= \frac{1,00,000}{3,00,000} \times 60,000 = \text{Rs. 20,000}
\]

**Contribution of insurer C:**

\[
= \frac{1,00,000}{3,00,000} \times 60,000 = \text{Rs. 20,000}
\]

So, this is how contribution is done by insurance companies.

In practice, almost all the fire insurance policies and majority of accidental policies contain a contribution clause.

### 6. Proximate Cause

The term 'cause proxima' is a latin phrase which means nearest or proximate or immediate cause.\(^\text{92}\)

Lord SHAW has given the definition of proximate cause as “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.”\(^\text{93}\)

The doctrine of proximate cause is expressed in the maxim “cause proxima non remota spectator” which means that the proximate and not the

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remote cause, shall be taken as the cause of loss. The insurer is thus has to make good the loss of insured that clearly and proximately results, whether directly or indirectly from the event insured against in the policy.  

The doctrine of proximate cause, which is common to all branches of insurance, is based upon the presumed intention of the parties as expressed in the contract into which they have entered. But it must be applied with good sense, so as to give effect to, and not to defeat that intention.

In other words, a proximate cause is the active and efficient cause, which sets the other causes in motion and brings about the loss. If the proximate cause is within the risk covered, the insured person can recover the compensation from the insurance company. But, if the loss is brought about by the cause which is attributable to the misconduct of the insured person, the insurance company is not liable.

**Illustration:**

A Cargo of flowers in a ship was insured against loss arising on account of perils of sea. The ship carrying the flowers was delayed by storm. Due to the delay, the flowers got deteriorated and were of no use. In such case, insurance company was not liable as the loss was not caused by the perils of sea but by the delay, which was not an insured peril.

7. **Mitigation of Loss**

Mitigation of loss refers to the minimization of the loss. When the insured event happens, it is the duty of the insured person to take all reasonable steps for the purpose of minimizing the loss. It is to be noted that the insured person is not required to risk his own life for this purpose. He is required to take such steps as an un insured rational person would take under the similar circumstances. And he should not become negligent or inactive on the happening of the event merely because the property is insured. If his

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94. See Stanley vs. Western Insurance Company, 1868, LR 371.
95. See Sreenivasan, MN, op. cit., p. 435.
96. See Gongya, PPS, op. cit, p. 701.
negligence is proved, the insurance company may avoid the payment of loss attributable to his negligence.\textsuperscript{97}

Illustration:

Sohan insured his goods against fire for Rs.80,000 with Khan insurance company. The fire broke out in the godown where these goods were lying. But Sohan did not take any step to put out the fire. The goods worth Rs.25,000 were destroyed in the fire and it was proved that out of this, the loss, of Rs.15,000 was due to Sohan’s negligence. In this case Khan Insurance Company may be liable to pay Rs.10,000 only.

Importance of Insurance

The importance of insurance may be studied under three heads:

(a) Importance to an individual
(b) Importance to business
(c) Importance to society

(A) Importance to an Individual

(i) Insurance provides security and safety to the individual.
(ii) Insurance provides peace of mind to the individual.
(iii) It eliminates dependency of individual on others in bad times.
(iv) Insurance serves as a source of savings.\textsuperscript{98}

(B) Importance to Business

(i) Insurance provides financial help in the business.
(ii) Insurance reduces uncertainty of business losses.
(iii) Insurance improves efficiency of the business.
(iv) Insurance provides indemnification.
(v) Insurance provides employees security in the business.\textsuperscript{99}

\textsuperscript{97} See Gongva, PPS, op. cit., p. 703.
(C) Importance to Society

(i) Insurance provides protection to society's wealth.

(ii) Insurance helps in increasing the economic growth of the country.

(iii) Insurance improves standard of living of the people of the country.

(iv) Insurance provides huge social security benefits to the society.

(v) Insurance helps in accelerating the production cycle of the economy.

(vi) Insurance helps in reducing the inflation.\textsuperscript{100}

Growth of Non-Life Insurance in India

Premium

The non-life insurance industry underwrote total premium of Rs.42.576 crore in 2010-11 as against Rs.34.620 crore in 2009-10, registering an impressive growth of 22.98 per cent as against an increase of 14.06 per cent recorded in the previous year. The public sector insurers has exhibited impressive growth rate of 14.49 per cent. The private general insurers have registered growth of 24.67 per cent, which is much higher than 13.44 per cent achieved during the previous year.

Gross Direct Premium Income in India of Non-Life Insurers

(Rs. In crore)

\begin{center}
\begin{tabular}{|c|c|c|}
\hline

Insurer & 2009-10 & 2010-11 \\
\hline

Public & 20643.45 & 25151.83 \\
& (14.49) & (21.84) \\
\hline

Private & 13977.00 & 17424.63 \\
& (13.44) & (24.67) \\
\hline

Total & 34620.45 & 42576.45 \\
& (14.06) & (22.98) \\
\hline

\end{tabular}
\end{center}

\textit{Source: Insurance Regulatory Development Authority (IRDA) Report, 2010-2011}

\textsuperscript{100} Id, p. 16.
Segment wise premium growth

The Motor business continued to be the largest non-life insurance segment with a share of 42.70 per cent (43.46 per cent in 2009-10). It reported growth rate of 20.82 per cent (12.83 per cent in 2009-10). The premium collection in Health segment has continued to surge ahead at Rs.9.944 crore in 2010-11 from Rs.7.311 crore of 2009-10, registering growth of 36.01 per cent. This has resulted in increase in share of health segment to the total premium to 23.35 per cent in 2010-11 (21.12 per cent in 2009-10) the growth in the Health segment far out-paced the growth rate achieved by the non-life industry as a whole. The premium collection from Fire and Marine segments increased by17.72 per cent and 16.20 per cent respectively in 2010-11 after remaining stagnant in 2009-10.

All public sector insurers (except United India) are underwriting non-life insurance business outside India. United India ceased its operations outside India in 2003-04. The total premium underwritten outside the country by the three public sector insurers stood at Rs. 1.265 crore in 2010-11 as against Rs. 1.195 crore in 2009-10 registering growth of 5.86 per cent (11.04 per cent in the previous year). The premium underwritten outside India accounted for 2.89 per cent of total premium underwritten.

New India has continued to be the largest public sector general insurer underwriting premium outside India, with the premium underwritten outside India constituting 13.71 per cent of the total premium underwritten by the insurer in 2010-11. In case of Oriental, the contribution of outside India premium to the total premium has worked out to 2.02 per cent in 2010-11, marginally lower than 2.43 per cent in 2009-10. National Insurance continued to have a small component of overseas business at 0.39 per cent in 2010-11, slightly lower than 0.45 per cent in 2009-10.
### Gross Direct Premium from Business outside India: Non-Life Insurers

(Rs. in crore)

<table>
<thead>
<tr>
<th>Insurer</th>
<th>2009-10</th>
<th>2010-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>National</td>
<td>20.81</td>
<td>24.47</td>
</tr>
<tr>
<td></td>
<td>(30.49)</td>
<td>(17.56)</td>
</tr>
<tr>
<td>New India</td>
<td>1056.63</td>
<td>1128.37</td>
</tr>
<tr>
<td></td>
<td>(11.58)</td>
<td>(6.79)</td>
</tr>
<tr>
<td>Oriental</td>
<td>117.97</td>
<td>112.55</td>
</tr>
<tr>
<td></td>
<td>(3.81)</td>
<td>(-4.60)</td>
</tr>
<tr>
<td>Total</td>
<td>1195.41</td>
<td>1265.39</td>
</tr>
<tr>
<td></td>
<td>(11.04)</td>
<td>(5.85)</td>
</tr>
</tbody>
</table>

*Source: Insurance Regulatory Development Authority (IRDA) Report, 2010-11*

Of the total premium of Rs. 1.265 crore written outside India in 2010-11, New India underwrote a higher premium of Rs. 1.128 crore (Rs. 1.056 core in 2009-10), its market share in the total outside India premium of public general insurers has increased to 89.17 per cent from 88.39 per cent in 2009-10. National underwrote a premium of Rs. 24.47 crore (Rs. 20.81 crore in 2009-10). The outside India premium underwritten by Oriental Insurance has stood at Rs. 113 crore which is lower than previous years Rs. 118 crore, recording a 4.60 per cent decline.
## Segment-wise Non-Life Premium

<table>
<thead>
<tr>
<th>Department</th>
<th>2009-10</th>
<th>2010-11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fire</td>
<td>11.18</td>
<td>10.70</td>
</tr>
<tr>
<td>Marine</td>
<td>6.26</td>
<td>5.92</td>
</tr>
<tr>
<td>Motor</td>
<td>43.46</td>
<td>42.70</td>
</tr>
<tr>
<td>Health</td>
<td>21.12</td>
<td>23.35</td>
</tr>
<tr>
<td>Others</td>
<td>17.98</td>
<td>17.33</td>
</tr>
<tr>
<td>Total Premium</td>
<td>100.00</td>
<td>100.00</td>
</tr>
</tbody>
</table>

*Source: Insurance Regulatory Development Authority (IRDA) Report, 2010-2011*

(Fig) Growth of Non-Life Insurance in India 2009-2011
From the above discussion it can be concluded that the non-life insurance sector witnessed significant growth of 8.1 percent during 2010. Its performance is far better when compared to global non-life premium, which expanded by 2.1 percent during the same period. The share of Indian non-life insurance premium in global non-life insurance premium increased slightly to 0.58 percent, thereby improving its global ranking to 19th in comparison to 26th in last year.
B. Under Islamic Legal System

In the contemporary world insurance has become of utmost importance for every individual and business of entire corporate world for reducing risks and losses and mitigating the huge impact of catastrophes on their lives and wealth. Financial institutions across the world came out with insurance to safeguard the business and individuals against losses. In 1970's when Islamic Banking initiated its operations, it created a need for a Shariah compliant alternative to conventional insurance, to be considered against the Shariah tenets due to the involvement of Riba, Gharar and gambling. To fulfill this gap in Islamic finance cycle, the concept of Islamic Insurance (Takaful) i.e. Takaful has been introduced and developed.\(^{101}\)

Islamic Insurance (Takaful) is a concept which has its roots in Islamic muamalat i.e. banking transactions, following the rules and regulation of Islamic law. Islamic Insurance (Takaful) has been practiced in numerous forms for more than 1400 years. It is originated from Arabic word Kafalah, which means "joint guarantee" or "guaranteeing each other". Islamic Insurance (Takaful) system is based upon the principle of mutual co-operation, responsibility, assurance, protection and assistance between groups of participants. It is a kind of Mutual Insurance.\(^{102}\)

Islamicity of Islamic Insurance (Takaful)

The principles of Islamic Insurance are based upon the holy verses of Quran and Hadiths of Prophet Mohammed (PBUH). There are few Quranic Verses and Hadith upon which various Islamic jurists had decided that the principles of Islamic Insurance (Takaful) are in tune with Islamic fundamentals. Few Quranic verses and Hadiths are as follows:

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1. **Basis of co-operation:** “Help one another in al-Birr and in al-Taqwa (virtue, righteousness and piety) but do not help one another in sin and transgression.”

2. **Basis of Responsibility:** The place of relationships and feelings of people with faith, between each other, is just like the body: when one of its parts is affiliated with pain, then the rest of the body will be affected.

3. **Basis of Mutual Protection:** By my life which is in Allah’s Power, nobody will enter Paradise if he does not protect his neighbour who is in distress.

4. Allah will always help his servant for as long as he helps others.

5. One the Muslims (Maumin) and another the Muslims (Maumin) is just like a building whereby every part is it’s strengthen the other part.

**Rationale of Islamic Insurance (Takaful)**

Islamic Insurance (Takaful) is founded on the idea that what is uncertain with respect to an individual may cease to be uncertain with respect to a very large number of similar individuals. Insurance by combining the risks of many people enables each individual to enjoy the advantage provided by the law of large numbers.

Generally Muslims societies avoid Commercial Insurance, mainly for two reasons. Firstly, it is regarded as unnecessary, because under Muslims societies members are required to help each other, especially the victims of any hazardous misfortune. Secondly, due to the severe prohibitions of Usuary (Riba), uncertainty (Gharar) and gambling (maysir) involved in the

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103. V:2
104. Narrated by Imam al-Bukhari and Imam Muslim.
105. Narrated by Imam Ahmad bin Hanbal.
106. Narrated by Imam Ahmad bin Hanbal and Imam Abu Daud.
107. Narrated by Imam al-Bukhari and Imam Muslim.
108. Siddiqui Nejatuallah Mohammad “Evolution of Islamic Banking and Insurance as system rooted in Ethics, read this paper at the college of Insurance, New York in Takaful form, April 26, 2000. Available at www.financeinislam.com
conventional insurance. Furthermore, conventional insurance companies are involved in other forbidden business, including alcohol, perk, indecent entertainment and other prohibited activities.

The second aspect is genuine and must be followed in order to avoid prohibitions, while the first one is only a myth. Islam itself provides that one must find ways to avoid uncertainties and disasters whatever and wherever possible, and to protect ones or one's family's burden if such event occur.

The principles of Shariah always intend to save human beings from hardships and distress. The Holy Quran says:

"Allah intends for you ease, and he does not want to make things difficult for you".\(^{109}\)

"Allah wishes to lighter (the burden) for you, and man was created weak".\(^{110}\)

One day Prophet Mohammad (PUBH) saw a person leaving a camel in the jungle, he asked him, "Why don't you tie down your camel"? He answered, "I put my trust in Allah". The Prophet (PUBH) said, "Tie your camel first, then put your trust in Allah".\(^{111}\)

From the above Quranic Verses and Hadith we can conclude that idea of getting protection cover against risk is permissible in Islam. The rule of necessity comes into play to find the proper solutions. Therefore Islamic scholars have desired it necessary and expedient to develop a system of insurance based upon Islamic principles to enable Muslims societies to protect themselves against misfortunes and lessen the burden of losses in a manner which is in consonance with the Shariah principles.\(^{112}\)

There are few definitions of Islamic Insurance (Takaful) as given by various scholars and Institutions:

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109. II:185.
110. IV:28
111. Narrated by Al-Tirmizi and Ibn Majah.
112. See Ayub, Mohammad, \textit{op. cit.}, pp. 418-419.
Definitions:

1. "Islamic Insurance (Takaful) is a process of agreement among a group of persons to handle the injuries resulting from specific risks to all of them are venerable. A process, thus initiated, involves payment of contributions as donations, and leads to the establishment of an insurance fund that enjoys the status of a legal entity and has independent financial liability."

   Accounting and Auditing organization for Islamic Financial Institutions, Bahrain

2. "Takaful is perceived as co-operative insurance, where members contribute a certain sum of money to a common pool."

   Emirates Institute for Banking and Financial studies

3. "Islamic Insurance (Takaful) policyholders co-operate to create a risk pool for a defined category of their risks, and contribute to a mutual underwriting fund from which benefits are payable to indemnify them in the case of losses arising from such risks."

   Islamic Financial Qualification, 2006

4. "Takaful is defined as joint guarantee, and is an agreement between group members, contractually in agreement between themselves for joint guarantee to protect and indemnify each others against a loss arising out of misfortune."

   Georgious Narraouti

5. "Takaful means Mutual protection and indemnity."

   Dr. Mohd. Daud Bakar

6. "Takaful refers to participants mutually contribute to a common fund with indemnity in case of loss."

   Syed Imran Raza Jafari
7. “In a Takaful arrangements the participants contribute a sum of money as a Tabarr'u (donation) in to a common fund that will be used mutually to assist the members against a defined loss or damage.”

Islamic Financial Services Board, exposure draft Dec 2008

8. “Takaful means a mutual guarantee or assurance based on the principles of al-aqd (contest) provided by a group of people living in the same society against a specific risk that befalls on an individual's life or possessions.”

Khaled Kassar

It is earnestly submitted that Islamic Insurance (Takaful) can be defined as a mutual agreement between the pool of people or participants, who are ready and willing to share all effects of risk that may be inflicted upon any one of them.

MEANING: Takaful is the Islamic counterpart of conventional insurance. The basic principle of Takaful is that it is a financial transaction involving mutual co-operation among two parties to protect one of them from unseen future risk. Under Takaful transaction insured pays a fixed amount of premium (amount of money) to the insurer with a mutual agreement that the insurer is legally bound to protect the insured from any unexpected loss which should happen within the agreed time period. On the other hand if loss does not occur within the stipulated time period, the insured is entitled to receive whole amount paid in form of premium along with the profits accumulated on the paid premiums based on the cardinal principle of Mudharbah, an Islamic financial technique. So, both the insurer and insured are bound mutually to help each other for financial transaction.

The bond of mutual co-operation between both the parties is in line with Quranic principle of mutual co-operation as Allah (SWT) commanded to the effect:
"And co-operate you one another in righteousness and piety."\textsuperscript{113}

Under Islam the practice of mutual co-operation is not given a free hand as a limit to it is set by Almighty prohibiting mankind from co-operating among themselves in any manner which incorporate sinful elements. Allah says to the effect:

"And do not co-operate in sin and rancour."\textsuperscript{114}

"And help one another towards piety and fearing of Allah, and do not help one another towards sinfulness and transgression."\textsuperscript{115}

From the above verses of the Holy Quran, we can say that practice of Takaful business is based upon the Islamic concept of mutual co-operation and solidarity if the transaction is operated based on the basic principle of al-Mudharabah which is permissible in the eyes of Allah and carried out with sincere dedication and intention of protecting the insured against future unexpected financial loss, it will not only benefit the insured but whole of the society.\textsuperscript{116}

Thus, it is clear that Takaful is based upon the principle of mutuality and it avoids any commercial contract between the insurer and the insured as the concept of providing identity under Takaful does not involve any idea of commercial relationship between the insurer and the insured. The crucial fact is that, the Takaful operator is not an insurer in case of the conventional insurance, but he is merely an operator who manages the Takaful business.

Thus, Takaful from the point of view of Arabic Morphology depicts that two or more parties providing indemnity to each other. As one party intends to indemnify the other party and expects the vice-verse. It is essential that every person must contribute a particular amount of money to a common fund, but it is not compulsory that all of those, who are contributing in this

\textsuperscript{113} V:3
\textsuperscript{114} Id.
\textsuperscript{115} V:2
fund are entitled to any consideration, as the actual payment of any indemnity (loss) will depend on the occurrence of a specified event against which the Takaful fund is established to provide indemnity. The system of Takaful gives an opportunity to every member of Takaful fund to be indemnified when he is entitled to the indemnity. It is also noted that the concept of Takaful is based on the principles of Shariah.\textsuperscript{117}

**The Shariah Basis of Islamic Insurance (Takaful)**

The near Shariah equivalent word for insurance in Arabic is "Tamein", which means to reassure, safeguard and guarantee through indemnity to losses. It also denotes trust, loyalty, confidence and fidelity and refers more to guarantee than to co-operative sharing of losses among a group.\textsuperscript{118}

Islamic Insurance (Takaful) is based on the following rules and regulations of Shariah which should be compulsorily mentioned in the documents of the company conducting Takaful business:

1. Donation Commitment (Tabbaru), as it should be stipulated that the participant donate his contribution and the returns there on to the insurance account for payment of indemnity and may undertake to bear any deficit that may occur, as per regulations.

2. The company that arranges the insurance deal should maintain two separate accounts, one for its own rights and liabilities, and the other for the rights and liabilities of the policyholders.

3. The company should ensure the role of the agent in managing the insurance account and the role of the Mudarib or agent in investing the insurance assets.

4. The insurance account is entitled to the insurance assets and their returns on investment and should bear the liabilities relating to these assets.

5. The adopted role may comprise disposal of the surplus in a way that serves the cause of common interest of the participants, such as accumulation of reserves, reduction of the contribution, charitable donations and partial or full distribution of the surplus among the


\textsuperscript{118} See Ayub Mohd, op. cit, p. 420.
participants. The managing company is not entitled to any share of the surplus.

6. When the company is liquidated, all provisions and accumulated reserves pertaining to insurance should be spent on charitable purpose.

7. Preference should be given to policyholders to participate in management of the insurance operations through appropriate legal arrangements that enable them to exercise their control rights and protect their interest. Such arrangements could include, among others, representation of policyholders in the Board of Directors.

8. The company should adhere to the rules and principles of Islamic Shariah in all activities and investment, especially in refraining from provision of insurance coverage for Shariah barred items, activities or purposes.

9. A Shariah Supervisory Board should be formulated for issuance of Fatwa (legal opinion) that are binding to the company and establishment of an internal unit for Shariah monitoring and auditing.\textsuperscript{119}

The above rules and regulations are provided by Shariah for the operation of Takaful business.

Reasons for Acceptability of Islamic Insurance (Takaful)

According of Islamic Scholars, the concept of Islamic Insurance (Takaful) is acceptable in Islam for the following reasons:

1. Policyholders co-operate among themselves for their common good.

2. Every policyholder pays his subscription to help those that need assistance.

3. Losses are divided and liabilities spread according to the community pooling system.

4. Uncertainty is eliminated in respect of subscription and compensation.

5. It does not derive advantage at the cost of others.\textsuperscript{120}


\textsuperscript{120} See "Takaful-Islamic Insurance (Takaful): Study Material of Emirates Institute for Banking and Financial Studies", Chapter-6, p. 44.
Characteristics of Islamic Insurance (Takaful)

Basically there are three important characteristics of Islamic Insurance (Takaful) which are as follows:

1. Mutual Help
2. Mutual Responsibility
3. Mutual Protection from losses.

Under the operating system of Islamic Insurance (Takaful) the person seeking protection engages himself in a scheme of co-operation with other persons to mutually insure one another. The corporation that was the Takaful scheme is not the insurer but is merely an institution which provides the technical and entrepreneurial skills required to bring the persons at one place, to collect, manage and invest the contributions and to process the claims.

Under Takaful system, the members of a group jointly agree to assure if anyone of them suffers a loss, he could be compensated by money collected in a Takaful fund by all the members.

Another significant characteristic of Takaful system is that, the funds collected from the participants are invested in profit and loss sharing ventures based on the Islamic principle of Mudharabah and not in interest earning enterprises. The profits from such investments are shared between the participants and Takaful Corporation in accordance with a pre-agreed ratio.\(^{121}\)

Essentials of Islamic Insurance (Takaful)

Insurance under Islam possesses certain essential ingredients upon which an insurance contract is to be held valid. Those essentials are classified into four main categories:

1. Sincerity
2. Shariah Principles
3. Presence of Moral Attributes
4. The Essentials of an Insurance Contract

1. **Sincerity**

   The first essential of Islamic Insurance (Takaful) is the requirement of absolute sincerity. Every Islamic Insurance (Takaful) transaction and dealing require absolute sincerity and pious intention so as to achieve the desired result from Allah.

   "And they have been commanded no more than this, to worship Allah offering his sincere devotion."^{122}

   This has further been elaborated by the tradition of the Prophet (PUBH) as Narrated by Omar Ibn Khattab the Holy Prophet (PBUH) is reported to have said:

   "The validity of the actions is depending on intention and therefore every man shall have but that which he intended."^{123}

   Thus, the parties to Takaful must have sincerity not to make profits, but to work upon the principles of mutual co-operation, solidarity and brotherhood, towards protecting one from unexpected future losses. This is because Allah never looks at any material gains but at the purity of sincerity in their hearts. The Holy Prophet (PUBH) said to this effect as narrated by Abu Huraira, the Holy Prophet (PBUH) is reported to have said:

   "Verily Allah never looks at your physical shape not at your appearance but considers sincerity in your hearts ...."^{124}

   Furthermore, in Takaful operations the parties must by all possible means put their trust and faith in Allah so as to get his protection from the consequential unexpected future loss. The rational behind this is that an insurer formally undertakes just to compensate the insured against a loss though the insurer is not liable to guarantee unlimited protection. The

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122. LXXXVII.5.
123. Bukhari and Muslim (agreed), Kitabul Imam
basis behind this is that Allah is the one who has the power of protection over all in the universe. The verse of Holy Quran reflects this:

“To him belongs the domination of the heaven and the earth: to give life and death: And He has the power over all things.”

2. Shariah Principles

The second essential of Islamic Insurance (Takaful) is the presence of Shariah Principles without which a Islamic Insurance (Takaful) content will not be valid. The Takaful Act of Malaysia, 1984 provides that Shariah based insurance is enforceable if it is in consonance with the principles of Shariah. Therefore a valid Takaful content should follow the Shariah principles. It is to be noted that Islam is one and the only system of life recognized by Allah and therefore it is logical that every Takaful transaction should obey the divine rules and regulations recognized by Allah. Any transaction which is not in line with such rules and regulations made by Allah will lost its validity. Allah says to the effect.

“If any one desires any system other than Islam it will never be recognized by Allah.”

3. Presence of Moral Attributes

An Islamic Insurance (Takaful) content must contain moral attributes and also confirm to moral sanctions. Those moral attributes and sanctions are categorized as followed:

1. The Principle of Good faith: Good faith is the essence of an Islamic Insurance (Takaful) contract. An Islamic Insurance (Takaful) contract must also involve honesty, full and fair disclosure of information

125. See Billah Masum, op cit, p396.
126. LVII:2.
127. See The Takaful Act, Malaysia, 1984, Section 2
128. III:19
129. See Billah Masum, op cit, p. 397.
130. III:85.
and truthfulness. The justification of this principle is given by the following verse of the Holy Quran:

"Do not misappropriate your property among yourselves in vanities."^{131}

2. **The Principle of Mutual Co-operation**: The parties involved in a *Takaful* contract must focus upon the principle of mutual co-operation to protect one from unexpected future losses rather than have intention to earn profits.\(^{132}\) This is in line with the divine sanction of Holy Quran:-

"Help the one another is righteousness and piety."\(^{133}\)

4. **Essentials of An Insurance Contract**

The following essentials are required in a *Shariah* based Islamic Insurance (*Takaful*) Transaction:-

a) The parties to the contract must be legally capable to enter into contract.

b) There must be the presence of insurable interest.

c) It must contain an indemnity clause i.e. insurer is bound to compensate the insured for loss suffered.

d) There must be timely payment of premiums.

e) There must be presence of mutually free consent of the parties. This requirement has been justified by the *Quranic Sanction*:-

"Do not misappropriate your property among yourselves in vanities, but let there be amongst you traffic and trade by mutual good-will."\(^{134}\)

f) Offer and acceptance are to be expressed in a formal agreement, in compliance with *Shariah* principles.

g) Policy must contain the time period of indemnity clause.

h) Last but not the least *Takaful* operations are to be based upon the principle of *al-Mudharabah* financing technique.\(^{135}\)

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131. IV:29.
132. See Billah Masum, *op cit*, p. 397.
133. V:3.
134. IV:29.
PRINCIPLE OF ISLAMIC INSURANCE (TAKAFUL)

Following are the main principles of Islamic Insurance (Takaful):

1. **Principle of Al-Mudarbah**: Al-Mudarbah is the main and basic principle of Islamic Insurance (Takaful). It is a technique of trust financing where there is an agreement between two parties, one is the financier (rab-al-maal), the other the entrepreneur (Mudarib). The profit is shared out in accordance with the contract. The entrepreneur being rewarded for his efforts and the financier who can be the bank or an individual for the use of his capital and the risk in providing the capital.\(^{136}\)

2. **Principle of State Supervision and Control**: The main aspects of Islamic Insurance (Takaful) must be controlled and managed by the state authority based on the Shariah rules and regulation and nothing should be left unchecked and unadhered too. The objective behind this is to ensure the legality and fairness of all transactions operated by insurance companies dealing with Islamic Insurance (Takaful), since insurance businesses are considered as trust businesses, where by insurance companies undertake to protect the insured from unexpected future losses.\(^{137}\) The present researcher is also agreed with Dr Nejatullah Siddiqui when he says:

“All insurance concerning perils to lives, limbs and health should be dealt with exclusively under the Supervision of the state.”

I also agreed with him:

*That Insurance against peril involving money and property should also be run by the state.*\(^{138}\)

Thus it is clear that all types of insurance transactions should be dealt exclusively under the supervision and control of the state.

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137. Ibid, pp. 157-159.
3. **Principle of Agency (wakala):** Like the principle of Agency (wakala), the Islamic Insurance (Takaful) company also works as the agent of the policyholders, and receives a declared reinsinuation. Policyholders make contribution in two parts: a) Agency fees, b) risk sharing donation; that is credited to the policyholder’s fund. In this way the Islamic Insurance (Takaful) company assumes the role of an agent (wakil) of the policyholders backed by shareholders who have contributed capital to a shareholders fund that is managed separately from the policyholder’s fund.\(^{139}\)

4. **Principle of Guarantee (Daman):** Under Islamic Insurance (Takaful) insurer undertakes to guarantee a requisite protection for the insured against future unexpected loss, or risk. The basis of such guarantee lies in the fundamentals of old pre-Islamic Arabia principle of daman.\(^{140}\)

5. **Principle of Rights and Obligations:** Islamic Insurance (Takaful) policy has its fundamental basis in the principles of rights and obligations derived from humanity and nature. It is quite logical in every society that the person should get protection and be able to provide protection to its family, property, for the needed persons, helpless widows and children from unexpected future loss and risk.\(^{141}\) Such logic could well be justified by following tradition of the Holy Prophet (PBUH). Narrated by *Saad ibn Abi Waqqas* the Holy Prophet (PBUH) is reported to have said:

"It is better for you to leave your offspring wealthy than to leave them poor as kin others for help."\(^{142}\)

The Holy Prophet (PBUH) further highlighted the importance of providing protection to the widows and poor dependent in the following tradition: Narrated by *Safwan bin Salis*, the Holy Prophet (PBUH) said:-


\(^{140}\) See *Supra Note* 15, p.408.

\(^{141}\) See Billah, Mohd. Masum, *op cit* p 409.

\(^{142}\) See Sahih al Bukhari (trans. English) Khan, Dr. Muhammad Mushir, Kazi Publication, Lahore, 1979, vol. 8, No. 725, p. 477F.
“The one who looks after works for a widow and for a poor person, is like a warrior fighting for Allah’s cause or like a person who fasts during the day and prays overnight.”\(^{143}\)

6. **Principle of Mutual Co-operation:** Under Islamic Insurance (Takaful) both the insurer and the insured mutually agree to a lawful co-operation, whereby the insured provides capital to the insurer, enabling him to invest the capital in a lawful business based on the principle of Mudharabah, while the insurer, in return of the capital mutually agrees to compensate the insured from unexpected future loss or damage.\(^{144}\) Such mutual co-operation between the parties in Islamic Insurance (Takaful) transaction has been fairly justified by the divine principle of mutual co-operation, solidarity and brotherhood.\(^{145}\) The relevant Quranic verse to this effect is:-

“Serve your mutual co-operation among yourselves in righteousness and piety”\(^{146}\)

**Purpose of Islamic Insurance (Takaful)**

From Islamic point of view following are the purposes and goals of Islamic Insurance (Takaful):

1. Islamic Insurance (Takaful) protects helpless people from future unexpected loss which may cause hardship in their lives.\(^{147}\) Holy Prophet (PBUH) gave the advice to the Ummah to come forward to relieve the hardship. Narrated by Abu Huraira, the Holy Prophet (PBUH) is reported to have said that:

   “Whosoever removes a worldly hardship from a believer Allah will remove from him one of the hardships hereafter whosoever alleviates the needy person, Allah will alleviate from him in this world and the next”\(^{148}\)

2. Islamic Insurance (Takaful) helps in removal of poverty in the society and leads to a comfortable life. An insurance policy endures the insured

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143. Ibid, No. 35 p. 23.
144. See Billah, Mohd. Masum, op cit, pp. 410.
145. The takaful Act, 1984 (Malaysia), Section 2
146. V.3.
147. See Billah, Mohd. Masum, op cit, pp. 398.
against protection against the future unexpected loss.\textsuperscript{149} Allah also urges the people to have better life in this world and here in after. Allah says to this effect:-

\textit{our lord, give us a comfortable life in both the world and the here after.}\textsuperscript{150}

3. Islamic Insurance (Takaful) will lead to the entire development of mutual co-operation along with a spirit of brotherhood in the society.\textsuperscript{151} As Allah itself recommends the practice of mutual co-operation:-

\textit{Maintain a mutual co-operation among yourselves in righteousness and piety.}\textsuperscript{152}

4. Islamic Insurance (Takaful) practice creates a self sewing society as the benefit of Islamic Insurance (Takaful) makes sure to the insurer that he will not be dependent for help only other person in difficulties. The suitable Quranic Verse to explain this is:-

\textit{Allah intends on easy life for you while he does not want you to be in difficulties.}\textsuperscript{153}

5. Lastly, Islamic Insurance (Takaful) also has its implicit logic in the sense that it provides security for one from unpredicted loss, and this may encourage other people in the society to take insurance cover so as to protect themselves from future loss or damage.\textsuperscript{154} The relevant Quranic Verse to explain this is:-

\textit{Allah permitted trade and transaction while prohibited involvement in Usury.}\textsuperscript{155}

**Benefits of Islamic Insurance (Takaful)**

The working mechanism of Islamic insurance (Takaful) is based on mutual responsibility and co-operation between the parties in order to provide guarantee of protection to the participants. There are certain benefits of Islamic Insurance (Takaful) which are as follows:

1. **Future Protection Benefits:** Islamic Insurance (Takaful) provides protection cover in the form of mutual financial aid after paying request premium for a certain period of time. In case no unpredicted loss or

\textsuperscript{149} Ibid, p. 399.
\textsuperscript{150} II:201.
\textsuperscript{151} See Billah, Mohd. Masum, op cit, pp. 399.
\textsuperscript{152} V:3.
\textsuperscript{153} II:185
\textsuperscript{154} Id.
\textsuperscript{155} II:275
damage takes place, all premium money will be returned with certain amount of profit on it. The future protection benefits may be in the term of, Family Takaful benefits, and the General Takaful benefits.

2. More Savings: Islamic Insurance (Takaful) provides great opportunity to Muslims to increase their savings by investing in Islamic Insurance (Takaful) policy based on Shariah principles. Islamic Insurance (Takaful) company plays a crucial role as a saving institution to serve the future interest of Muslim Community.

3. Islamically Permitted Investment Opportunity: The basic feature of Islamic Insurance (Takaful) companies is that they mobilize and invest the savings of policyholders in Shariah permitted products. This provides a golden opportunity to the Muslims to invest their capital in accordance with Islamic principles.

4. Participation in the Economy in a Collective Way: Islamic Insurance (Takaful) provides a platform from where not only Muslims but non-Muslims are also able to participate in the economy in the most systematic way. Under Islamic Insurance (Takaful) there is a group of people pooling their resources for the benefits of other people. For example- the daughter of one family is going to get married, so people without being asked will try to assist in whatever manner they can. This illustration shows and emphasises the need to collectively participate so that the burden can be minimized.

5. Opportunity to Do Good Deals and Charitable Works: By investing in Islamic Insurance (Takaful) policy one is indirectly involved in charity and welfare of the people. Under Islamic Insurance (Takaful) system a policyholder contributes premium to be donated in a special fund and this amount to be used for the fellow participants who are suffering
from misfortunes. Thus Islamic Insurance (*Takaful*) is based upon the principle of “Mutually help each other in righteousness and piety.”\(^{156}\)

**PROHIBITED ELEMENTS IN TAKAFUL**

Under Islamic legal system, presence of certain elements are prohibited in the working of Islamic Insurance (*Takaful*), which are as follows:

**RIBA (Interest):**

*Riba* is usually translated in Urdu by the word ‘Sud’, which is of Persian origin and literally means ‘profits’. The basic meaning of *Riba* is ‘increase’ or ‘addition’ or ‘surpluses. In the *Shariah*, *Riba* stands for an addition to the principal amount and, by implication it means, for a payment for the use of money which has been fixed beforehand. But it is a form of excess of unjustified appropriation of income.\(^{157}\) The literal meaning of *Riba* as illustrated by the *Quran* in it at various places, such as-

i) **To Ground:**

> “And then beholdest the earth barren, then where we send down water upon it quicker and grows.”\(^{158}\)

ii) **To Increase:**

> “God destroys Riba but makes always prosper.”\(^{159}\)

> “And whatever you invest in Riba so that it may increase upon the people’s wealth it increase not with God.”\(^{160}\)

iii) **To Rise:**

> “And we gave them refuge upon a height.”\(^{161}\)

> “As the likeness of a garden upon a hill.”\(^{162}\)

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158. XXII:5.
159. II:276.
160. XXX:39.
161. XXIII:50.
iv) To Swell:

"Then the torrent carried a swelling sum."

v) To Nurture:

"My Lord, have mercy upon them (i.e. my parents) as they rised me up when I was little."

"Did we not raise that amongst no as a child."

vi) Argumentation Increase in Power etc as:

"He seized than with a surpassing grip."

"That one motion be more powerful than other motion."

Now we will see why Riba is prohibited and there are number of Quranic Verses to support this motion:

1. "Those that live on Usuary shall rise up before Allah like man whom sat on has dissented by his touch, for they claim that Usuary is like trading. But Allah has permitted trading and forbidden Usuary. He that receives an admonition from his Lord and mends his way may keep what he has already caved, his fate is in the hands of Allah. But that pays no heed shall be consigned to Hell-fire and shall remain in it forever."

2. "Allah has laid His course on Usuary and blessed alms giving with increase. He bears no love for the impious and the sinful."

3. "Believers have fear of Allah and waive what is still due to you from Usuary, if your faith be true."

4. "Believers do not live on Usuary, doubling your wealth many times over. Have fear of Allah and you shall prosper."

5. "Because of their iniquity, we forbade the Jews good things which were formerly allowed them; because time after time they have debared others from the path of Allah."
6. "Because they practice Usury—although they were forbidden it, and cheat others of their possessions, we have prepared for those of them that disbelieve a stern chastisement."\(^{173}\)

7. "That what you seek to increase by Usury shall not be blessed by Allah, but the alms you give for this sake shall be repaid to you many times over."\(^{174}\)

The last two verses may not include an outright bar on Riba, they only state that Riba earnings are not blessed by God. An insurance contract has an element of Riba that is why it is prohibited under Islam.

**SECULAR VIEW ON THE PROHIBITION OF RIBA**

There are few secular views which provide a bare for the prohibition of Riba:

1. Some authors are of the opinion that money in itself is not a factor of production and that a loan of money which does not hand in hand with at least some entrepreneurial risk taking should not bring a reward. Money or capital could only be witnessed as a factor of production when combined with entrepreneurship.

2. Others have pointed out that capitalists reinvest their income. Capital accumulation makes the rate of profit fall, but interest rates will increase and in order of maintaining profits, the capitalists will lower wages or dismiss workers. Riba, thus creates exploitation and unemployment.

3. A common man's view on the prohibition of Riba is that interest means a transfer of wealth from the poor to the rich, turns people away from productive enterprise or makes people selfish and stingy-heated.

**KINDS OF RIBA**

From Islamic point of view Riba has been classified into following:

1. **RIBA BY WAY OF DEFERMENT (Riba al-nasia):**

   Riba is created by delaying completion of on exchange of counter values and includes interest in the conventional sense of a pre determined payment for a loan, which may be a loan of money or a loan of goods.

172. IV:160.
173. IV:161.
2. **RIBA BY WAY OF EXCESS (Riba al Fadl):**

Riba by way of excess means an excess or increase paid in a direct exchange of commodities.

3. **RIBA BY WAY OF LOAN (Riba al Jahiliyya):**

It is related to the transactions in which no increase was stipulated at the time of advancing a loan; however, if the debtor could not pay the principal amount at the time of maturity, the creditor used to offer him two options: either to pay the principal or to increase the amount in exchange for an additional term allowed by the creditor.  

**GHARAR (Uncertainty)**

The word ‘Gharar’ in the Arabic language means risk. It also has the connotation of deception and delusion. Basically gharar means unknown or uncertain factors taking place in the commercial transactions. Islam prohibits gharar transactions because a party who is entering into the contract do not has sufficient knowledge of the facts of the contract and its result. Therefore, this can arise when the terms of contract contains the elements of doubt, uncertainty or indeterminacy. The another stipulation which gives birth to the gharar is that when the nature of contract itself gives rise to the possibility of fraud or deceit by one of the parties, such as when its terms are vague or uncertain. The bar on gharar stands for the sake of transparency and fairness.

So, it is clear that in an insurance contract containing the essential element of gharar, under which neither the insurer nor the insured knows the nature of the contract nor limits of their rights and liabilities until the occurrence of the insured event take place.

**JUHALA**

Literally juhala means “uncertainty per se”. Islam also prohibits juhala transactions. The pre-requisite of juhala is that all the information’s pertaining

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175. Id.
176. Id.
to the contract must be known to the parties at the time of entering into the contract, otherwise the contract is not valid.

Under life insurance contract, there is a presumption that the policy contrives and the parties remain bound by the contract until the occurrence of the insured event. The insured do not have any idea how long he will be paying the premiums or what will be the exact amount to be paid. On the other hand when the insured gets the policy money including dividends and profits, neither the insured nor the insurer knows the exact amount that will be paid on the happening of the insured event.

Under non-life insurance i.e. general insurance, there is a presence of juhala. As most of the general insurance policies contained yearly contracts. So the insured has the knowledge of the amount of premium that he is required to pay for the year but he has no idea of the amount which the insurer will pay him on the happening of the insured event.178

MAYSIR (Gambling)

Maysir is a form of gambling. It means receiving profits without putting any effort. Basically Maysir is an activity where the sole intention is of windfall profits. For example- In a lottery where winning amount far above the cost of “purchased lottery ticket.” Islam prohibits all transactions containing the element of Maysir.179 There are certain Quranic Verses to support the prohibition on the transactions involving the elements of Maysir:-

“They ask you about drinking and gambling, say: There is great harm in both, although they have some benefit for men; but, their harm is for greater their benefits.”180

“Believers, wine and games of chance, idols and divining arrows, are abominations devised by Satan. Avoid them, so that you may prosper.”181

179. See Kassar, Khaled, op. cit p.30.
180. II:219
181. V:90.
“Satan seeks to stir up enmity and hatred among you by means of wine and gambling, and to keep you from the remembrance of Allah and from your prayers will you not abstain from them.” 182

The above Quranic verses show the element of gambling. In a gamble the gambler pays a certain amount of money and subsequently hopes for a chance to gain an additional large amount of money. Any transaction involving such element of gambling is prohibited in the Sharia’h.

The researcher would like to conclude that Islamic Insurance (Takaful) works on the principle of mutual cooperation and mutual help among the members of a defined group. In other words Takaful is a method of joint guarantee among a group of members or participants against loss or damage that may be suffered by any of them. The members of the group by pooling their contributions agree to mutually guarantee the participants against a loss due to a catastrophe or disaster suffered by any of them. On the occurrence of the event the sufferer would receive a certain sum of money to meet the loss or damage. Thus, the main objective of Takaful system from policy holder’s point of view is mutual help and not earning profits or any windfall gains as in case of insurance under common legal system.

182. V-91.