CHAPTER – V

OPERATIONAL FRAMEWORK OF INSURANCE

A. UNDER COMMON LEGAL SYSTEM
B. UNDER ISLAMIC LEGAL SYSTEM
Chapter-5

OPERATIONAL FRAMEWORK OF INSURANCE

A. Under Common Legal System

Any sector, which touches the life of common men needs regulation, particularly so when inequalities and disparities of different types are likely to occur on account of the action or inaction on the part of the economic agents involved. For example, there may arise inequalities of opportunity, inequalities of income, wealth, regional imbalances, inter-sectoral imbalances, inequalities in social infrastructure, etc. This becomes particularly relevant in India since it has adopted liberalization, globalization and privatization policy. Moreover the market in India is not well-developed and cannot be relied upon for ensuring the process of deregulation.

Under liberalization, the role of government is expected to shift from that of a producer and provider to that of a protector. The model of the state as the owner of the means of production, the producer and provider of the goods and services as well as the regulator, has turned out, in most parts of the world to be too inefficient to meet the rising expectations of the consumers. The government can fulfil its varied responsibilities effectively and efficiently only if there is a well-equipped machinery in place. They cannot be handled through a department of the government, but are best left to a body of experts, which takes collective decisions and not at the discretion of a government official who reports directly to the government and can, therefore, be influenced in his decisions. The transition from a command economy dominated by the public sector to a market economy where the private sector is more active needs to be organized carefully. This has been corroborated by the experience even in developed countries which are proponents of the free market economy, but which after the deregulation
process was carried out, had to set up regulatory authorities for different sectors.\(^1\)

**Need of Regulation of Insurance**

Regulation is of immense importance in areas like financial transactions, where chances of mismanagement, deception, fraud etc. are more frequent. If such malpractices do occur, the loser is the common man who does not understand the intricacies of the transaction and can be mislead. Hence, social supervision, that is, government supervision, becomes essential. This is true for all the sectors in the financial services such as, banking, stock markets and insurance.

In common with other financial services, insurers are repositories of public trust and accept money from the insured in return for a promise of payment at some future date or on the occurrence of some particular event. An insurance company can fulfil this commitment only if it has an adequate professional capability, financially soundly managed, holds adequate reserves to meet the requirement of funds with reference to the nature of term of liabilities and invests its huge funds carefully.

Collaborations with foreign companies which are globally experienced and are large in size are no guarantee that all such companies will behave well. Reckless rate wars, undercutting, unhealthy links with industrial houses and a disregard for prudential norms are not totally unknown in other markets. Hence the need of the hour is to regulate them strictly. Accordingly they are subjected close regulations by the state in all countries, with the objective of ensuring that their business is run fairly, conducted by competent persons and protects the legitimate interests of the insuring public is well protected.

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It is not as if regulation becomes necessary only when there are private players in the field. There are operations which require professional regulation in areas relating to expenses, customer service, claim settlements, resolution of disputes, reasonableness of tariffs, and prevention of restrictive trade practices. The Malhotra Committee (1994) also felt that the insurance regulatory apparatus should be activated even in the present set up of the insurance sector and recommended the establishment of a strong and effective Insurance Regulatory Authority in the form of a statutory autonomous Board on the lines of the SEBI. (Securities Exchange Board of India).

The experience of the banking sector and the capital markets, where regulatory mechanisms have been set up and regulations have been enforced with some firmness, has been good. Thus, the banking sector has a Board for financial supervision since November 1994, and the stock markets are overseen by the SEBI. Insurance has seen the emergence of the IRDA (Insurance Regulatory and Development Authority), which has become functional since the beginning of the year 2000.2

With the private sector's entry into the insurance business, a regulatory system became even more necessary in the insurance industry where large monetary stakes are involved and for which there are parallels in other parts of the world. The Malhotra Committee (1994) also observed that while regulation over the other financial sectors has been strengthened, the regulation of the insurance industry is being organised in a peculiar manner under which the industry itself has been also its regulator. This rendered the concept of regulation itself ineffective. It, therefore felt, that the re-establishment of effective regulation over the insurance business would become all the more urgent if the sector were to be liberalized.

To put this in place, special dispensations given to the LIC and GIC and its subsidiary company by government notifications had to be withdrawn so that they did not enjoy a favoured treatment vis-à-vis other insurers. In the light of this, the government set up a regulatory mechanism in the form of the IRDA to ensure that the same regulation is applicable equally and seriously to all the players, public and private. In this sense, the IRDA is not an active player, but really a referee. This will ensure equity and social justice and at the same time prevent a recurrence of the old malaise and emergence of new monopolies. The IRDA has taken active steps towards closely monitoring the industry and bringing in some discipline therein.

Regulation is often opposed on the ground that regulations render the market less competitive, less efficient and inhibit entrepreneurship. Regulations are also perceived to be inflexible, expensive and administered as in a 'command and control' fashion. However, these anxieties are misplaced, because in essence, regulation is to be used as an efficient mechanism for permitting the financial market place to work. Although in certain quarters there are misunderstanding and reservations about regulation in general and a regulatory authority in particular, it is really in the general interest of the economy as well as the insurers themselves to have a sound regulatory mechanism. This is the only way to ensure that all the players in the market are brought under the same discipline and the interests of the insured are adequately protected. Without regulation the individual would be unable to differentiate between honest, unscrupulous or shaky insurers.  

### Regulatory Framework of Insurance in India

The main regulations that regulate the insurance business are the Insurance Act, 1938, the Life Insurance Corporation Act, 1956, the General Insurance Business (Nationalisation) Act, 1982, the Marine Insurance Act, 1988, the Motor Vehicles Act, 1939, and the Factories Act, 1947.

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1. Deposits

Every insurer should, in respect of the insurance business carried on by him in India, deposit with the Reserve Bank of India (RBI) for and on behalf of the Central Government of India the following amounts, either in cash or in approved securities estimated at the market value of the securities on the day of deposit, or partly in cash and partly in approved securities:

- in the case of life insurance business, a sum equivalent to one per cent of his total gross premium written in India in any financial year commencing after the 31 day of March, 2000, not exceeding rupees hundred million;

- in the case of general insurance business, a sum equivalent to three per cent of his total gross premium written in India in any financial year commencing after the 31 day of March, 2000, not exceeding rupees hundred million;

- in the case of re-insurance business, a sum of rupees two hundred million.

- If business done or to be done is marine insurance only and relates exclusively to country craft or its cargo or both, only rupees one hundred thousand should be deposited with the RBI.

These deposits will be held by the RBI though for the credit of the insurer and are returnable to the insurer in the event the provisions of the Insurance Act mandate such return. Interest accruing, due and collected on

deposited securities will be paid to the insurer, subject to any deductions of the normal commission chargeable for the realization of interest. In addition, it is important to note that the deposits will:

- Not be susceptible to any assignment or charge: or
- Not be available for the discharge of any liability of the insurer other than liabilities arising out of policies of insurance issued by the insurer so long as any such liabilities remain un-discharged, or
- Not be liable to attachment in execution of any decree except a decree obtained by a policy-holder of the insurer in respect of a debt due upon a policy which debt the policy-holder has failed to realize in any other way.

Where the insurer has ceased to carry on all classes of insurance business in India, the deposit made with the RBI shall, on an application being made to the Court, be returned to the insurer after satisfaction of all his liabilities in India in respect of all classes of insurance business.\(^5\)

2. **Investments**

Every insurer is required to invest and keep invested certain amount of assets as determined under the Insurance Act. The funds of the policyholders cannot be invested (directly or indirectly) outside India.

(a) **Life insurance**

An insurer involved in the business of life insurance is required to invest and keep invested at all times assets, the value of which is not less than the sum of the amount of its liabilities to holders of life insurance policies in India on account of matured claims. The amount required to meet the liability on policies of life insurance maturing for payment in India, reduced by the amount of premiums which have fallen due to the insurer on such policies but have not been paid and the days of grace for payment of which have not

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5. See Indian Insurance Act, 1938, Sec. 7.
expired. Any amount due to the insurer for loans granted on and within the surrender values of policies of life insurance maturing for payment in India issued by him or by an insurer whose business he has acquired and in respect of which he has assumed liability.

Every insurer carrying on the business of life insurance is required to invest and at all times keep invested his controlled fund (other than funds relating to pensions and general annuity business and unit linked life insurance business) in the following manner, free of any encumbrance, charge, hypothecation or lien:

**Government Securities:**
- 25 percent

**Government securities or other approved securities:**
- Not less than 50 percent

**Approved investments:**
- **(a) Infrastructure and social sector:** Not less than 15%
- **(b) Other to be governed by Exposure/Prudential Norms:** Not exceeding 35%

**Other than in Approved Investments to be governed by Exposure/Prudential Norms:** Not exceeding 15%

**Exposure/Prudential Norms:**

For the purposes of calculating the investments, the amount of deposits made with the RBI by the insurer in respect of his life insurance business shall be deemed to be assets invested in Government securities. In computing the assets to be invested by the insurer, any investment made with reference to the currency other than the Indian rupee which is in excess of the amount required to meet the liabilities of the insurer in India. With reference to that currency to the extent of such excess and any investment made in purchase of any immovable property outside India, or on account of any such property shall not be taken into account. Further, an insurer should not out of his controlled fund invest any sum in the shares or debentures of any private limited company.

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6. See Indian Insurance Act, 1938, Sec. 27 (i) & (ii)
Where an insurer has accepted reassurance in respect of any policies of life insurance issued by another insurer and maturing for payment in India or has ceded reassurance to another insurer in respect of any such policies issued by himself, the assets to be invested by the insurer shall be increased by the amount of the liability involved in such acceptance and decreased by the amount of the liability involved in such cession.

In case of an insurer incorporated or domiciled outside India or an insurer incorporated in India whose share capital to the extent of one-third is owned by, or the members of whose governing body to the extent of one-third consists of members domiciled elsewhere than in India, the assets required to be invested should, (except to the extent of any part which consists of foreign assets held outside India) be held in India by way of a trust for the discharge of the liabilities.

Every Insurer shall invest and at all times keep invested his segregated fund of unit linked life insurance business as per pattern of investment offered to and approved by the policy-holders. The insurer is permitted to offer unit linked policies only where the units are linked to categories of assets that are both marketable and easily realizable. However, the total investment in other approved category of investments should at no time exceed twenty five per cent of the funds.\textsuperscript{7}

(b) **General Insurance**

An insurer carrying on general insurance business is required to invest and keep invested at all times his total assets in approved securities in the following manner:

<table>
<thead>
<tr>
<th>Securities</th>
<th>Minimum Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Government Securities</td>
<td>Not less than 20%</td>
</tr>
<tr>
<td>State Government Securities and other guaranteed</td>
<td>Not less than 30%</td>
</tr>
<tr>
<td>Securities including the aforesaid:</td>
<td></td>
</tr>
<tr>
<td>Housing and Loans to state Government for</td>
<td>Not less than 5%</td>
</tr>
</tbody>
</table>

\textsuperscript{7} See Indian Insurance Act, 1938, Sec. 27(3), (iv), (v) \& (vi).
Housing and Fire Fighting Equipment

Investments in Approved Investments

(a) Infrastructure and Social Sector: Not less than 10%

(b) Other to be governed by Exposure/Prudential Norms: Not exceeding 30%

Other than in Approved Investments to be governed by Not exceeding 25%

Exposure/Prudential Norms:

(c) Pension and General Annuity

Every insurer is required to invest and at all times keep invested assets of pension business, general annuity business and group business in the following manner:

Government Securities: Not less than 20%

Government securities and other approved securities, Not less than 40%

Including the above:

Balance to be invested in Approved Investments and Not less than 60%

To be governed by Exposure/Prudential Norms.8

(d) Re-insurance

Every re-insurer carrying on re-insurance business in India is required to invest and at all times keep invested his total assets in the same manner as specified for the general insurance business.9

3. Valuation of Assets – Liabilities and Solvency Margins

An insurer should maintain, at all times, an excess of the value of his assets over the amount of his liabilities of not less than the relevant amount arrived at in the following manner ["required solvency margin"]:10

8. See Indian Insurance Act, 1938, Sec. 27B
9. See Indian Insurance Act, 1938, Sec. 101A
10. See Indian Insurance Act, 1938, Sec. 64 VA (i)
(a) in the case of an insurer carrying on life insurance business, the required solvency margin shall be the higher of rupees five hundred million (one billion in case of re-insurers) or the aggregate sum arrived at based on the calculations specified in the Insurance Act.\textsuperscript{11}

(b) in the case of an insurer carrying on general insurance business, the required solvency margin, shall be the highest of the following amounts:

(i) rupees five hundred million (rupees one billion in case of a re-insurer): or

(ii) a sum equivalent to twenty per cent of net premium income; and

(iii) a sum equivalent to thirty per cent of net incurred claims.\textsuperscript{12}

This shall be subject to credit for re-insurance in computing net premiums and net incurred claims being actual but a percentage, determined by the regulations, not exceeding fifty per cent.

An insurer who fails to maintain the required solvency margin will be deemed to be insolvent and may be wound up by the court. An insurer is required under the IRDA [Assets, Liabilities and Solvency Margin of Insurers) Regulations, 2000. to prepare a statement of solvency margin in accordance with Schedule III-A, in respect of life insurance business, and in Form KG in accordance with Schedule III-B, in respect of general insurance business, as the case may be.

Every insurer is required to prepare a statement of the value of assets in accordance with the provisions of the aforesaid regulations. Every insurer should prepare a statement of the amount of liabilities in accordance with the provisions of Schedule II-A of the aforesaid regulations, in respect of the life insurance business, and in Form HG in accordance with Schedule II-B, in respect of the general insurance business.

\textsuperscript{11} See Indian Insurance Act, 1938, Sec. 64VA (1A), (i)
\textsuperscript{12} See Indian Insurance Act 1938, Sec. 64VA (1A) (ii)
The aforesaid forms should be furnished separately for business within India and the total business transacted by the insurer.

In the event that an insurer transacts insurance business in a country outside India and submits the statements or returns or any such particulars to a public authority of that country, he is required to enclose such particulars along with the Forms specified in the aforesaid regulations and the IRDA (Actuarial Report and Abstract) Regulations, 2000.13

4. Submission of Returns

Every insurer should submit to the Authority the following returns, showing that as of 31st day of December of the preceding year the assets held and invested, investments made out of the controlled fund and all other particulars necessary to establish that the requirements of the Insurance Act have been complied with.14

<table>
<thead>
<tr>
<th>Form Number</th>
<th>Description</th>
<th>Period of Filing</th>
<th>Times limit for submission</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form 1</td>
<td>Statement of investment &amp; income on investment</td>
<td>Yearly</td>
<td>Within 30 days from the date of Board Approval of audited accounts.</td>
</tr>
<tr>
<td>Form 2</td>
<td>Statement of down graded investments</td>
<td>Quarterly</td>
<td>Within 21 days of the end of each quarter</td>
</tr>
<tr>
<td>Form 3A</td>
<td>Statement of investment of Controlled Fund (Life) Compliance Report</td>
<td>Quarterly</td>
<td>Within 21 days of the end of each quarter</td>
</tr>
<tr>
<td>Form 3B</td>
<td>Statement of investment of Total Assets (General) - Compliance Report</td>
<td>Quarterly</td>
<td>Within 21 days of the end of each quarter</td>
</tr>
<tr>
<td>Form 4</td>
<td>Prudential Investment Norms - Compliance Report</td>
<td>Yearly</td>
<td>Within 30 days from the date of Board Approval of audited accounts</td>
</tr>
</tbody>
</table>

13. See Indian Insurance Act, 1938, Sec. 64VA
14. Id.
5. **Actuary**

An insurer carrying on the business of insurance or reinsurance in India is required under the IRDA [Appointed Actuary] Regulations, 2000, to appoint a person fulfilling the eligibility requirements, to act as an appointed actuary, after seeking the approval of the Authority in this regard. It is mandatory for an insurer carrying on the business of life insurance in India to appoint any actuary.15

**Powers, Duties and Obligations of an Actuary**

An appointed actuary has access to all such information and documents of an insurer for the performance of his duties and obligations. An appointed actuary may also attend the meetings of the insurer and discuss matters related to the actuarial advice and solvency of margin.

An appointed actuary, in addition to rendering actuarial advice to insurer (in particular in the areas of product design and pricing, insurance contract wording, investments and reinsurance), is also required inter alia to ensure the solvency of the insurer at all times, certify the assets and liabilities that have been valued and maintain the solvency margin.

In case the insurer is carrying on life insurance business, an appointed actuary should also inter alia -

- certify the actuarial report, abstract and other returns required under the Insurance Act.
- comply with the provisions with respect to the bases of premium,
- comply with the provisions with respect to recommendation of interim bonus or bonuses payable by the life insurer to policyholders whose policies mature for payment by reason of death or otherwise during the inter-valuation period, and
- ensure that the policyholder’s reasonable expectations have been considered in the matter of valuation of liabilities and distribution of surplus to the participating policyholders who are entitled for a share of surplus.

15. See Indian Insurance Act, 1938, Sec. 2 (i)
In case of an insurer carrying on general insurance business in India, the appointed actuary is required to ensure that the rates are fair in respect of those contracts that are governed by the insurer's in-house tariff and that the actuarial principles, in the determination of liabilities, have been used in the calculation of reserves for incurred but not reported claims and other reserves where actuarial advice is sought by the Authority.\textsuperscript{16}

**Actuarial Report and Abstract**

Every insurer carrying on life insurance business should every year cause an investigation to be carried out by an actuary with respect to financial condition of the life insurance business including a valuation of his liabilities and should cause an abstract of the report to be made. This provision shall apply in the event that an investigation into the financial condition of the insurer is made with a view to the distribution of profits or an investigation is made of which the results are made public.\textsuperscript{17}

6. **Insurance Advertisements**

The IRDA [Insurance Advertisements] Regulations, 2000, seeks to regulate and control every insurance advertisement\textsuperscript{18} issued by the insurer,

\begin{itemize}
\item[(i)] newspapers, magazines and sales talk;
\item[(ii)] billboards, hoardings, panels;
\item[(iii)] radio, television, website, e-mail, portals;
\item[(iv)] representations by intermediaries;
\item[(v)] leaflets;
\item[(vi)] descriptive literature/circulars;
\item[(vii)] sales aids flyers;
\item[(viii)] illustrations from letters;
\item[(ix)] telephone solicitations;
\item[(x)] business cards;
\item[(xi)] videos;
\item[(xii)] faxes; or
\end{itemize}

\textsuperscript{16} See The Indian Insurance Rules, 1939, Sec. 5-9.

\textsuperscript{17} See Indian Insurance Act, 1938, Sec. 81

\textsuperscript{18} See Regulation 2(b), IRDA (Insurance Advertisements) Regulation, 2000: "Insurance advertisements" means and includes any communication directly or indirectly related to a policy and intended to result in the eventual sale or solicitation of a policy from the members of the public, and shall include all forms of printed and published materials or any material using the print and or electronic medium for public communications such as:

(i) newspapers, magazines and sales talk;
(ii) billboards, hoardings, panels;
(iii) radio, television, website, e-mail, portals;
(iv) representations by intermediaries;
(v) leaflets;
(vi) descriptive literature/circulars;
(vii) sales aids flyers;
(viii) illustrations from letters;
(ix) telephone solicitations;
(x) business cards;
(xi) videos;
(xii) faxes; or
intermediary\textsuperscript{19} or insurance agent. For this purpose, every insurer, intermediary or insurance agent is required to establish and maintain a system of control over the content, form and method of dissemination of all advertisements concerning its policies and such advertisement should be filed with the Authority as soon as it is first issued. An advertisement issued by an insurer should not fall in the category of an unfair or misleading advertisement. An unfair or misleading advertisement means and includes any advertisement

\begin{itemize}
  \item that fails to clearly identify the product as insurance;
  \item makes claims beyond the ability of the policy to deliver or beyond the reasonable expectation of performance;
  \item describes benefits that do not match the policy provisions;
  \item uses words or phrases in a way which hides or minimizes the costs of the hazard insured against or the risks inherent in the policy.
\end{itemize}

(xiii) any other communications with a prospect or a policyholder that urges him to purchase, renew, increase, retain, or modify a policy of insurance.

\textit{Explanation:} The following materials shall not be considered to be an advertisement provided they are not used to include the purchase, increase, modification, or retention of a policy of insurance: (i) materials used by an insurance company within its own organization and not meant for distribution to the public; (ii) communications with policy holders other than materials urging them to purchase, increase, modify, surrender or retain a policy; (iii) materials used solely for the training, recruitment, and education of an insurer’s personnel, intermediaries, counselors and solicitors, provided they are not used to induce the public to purchase, increase, modify or retain a policy of insurance; (iv) any general announcement sent by a group policy holder to members of the eligible group that a policy has been written or arranged.

19. See Regulation 2(c), IRDA (Insurance Advertisements) Regulations 2000; “Intermediary or insurance intermediary” includes insurance brokers, reinsurance brokers, insurance consultants, surveyors and loss assessors, or any other persons representing or assisting an insurer in one or more of the following:

(i) soliciting, negotiating, procuring, or effectuating an insurance contract or renewal of an insurance contract;
(ii) disseminating information relating to coverage or rates;
(iii) forwarding an insurance application;
(iv) servicing and delivering an insurance policy or contract;
(v) inspecting a risk;
(vi) setting a rate;
(vii) investigating or assessing a claim or loss;
(viii) transacting a matter after the effectuation of a contract;
(ix) representing or assisting an insurer or other person in any other manner in the transaction of insurance with respect to a subject of insurance resident, located or to be performed in India; or
(x) servicing a policy or contract
omits to disclose or discloses insufficiently, important exclusions, limitations and conditions of the contract;

gives information in a misleading way;

illustrates future benefits on assumptions which are not realistic nor realizable in the light of the insurer's current performance;

where the benefits are not guaranteed, does not explicitly say so as prominently as the benefits are stated or says so in manner or form that it could remain unnoticed;

implies a group or other relationship like sponsorship, affiliation or approval, that does not exist;

makes unfair or incomplete comparisons with products which are not comparable or disparages competitors.20

Every advertisement should disclose the full particulars and identity of the insurer, and that insurance is the subject matter of solicitation. In the event that such advertisement describes any benefits, the form number of the policy and the type of coverage should be fully disclosed. In case of Internet advertisements, the website or portal of the insurer or intermediary should contain disclosure statements which outline the site's specific policies vis-à-vis the privacy of personal information for the protection of both their own businesses and the consumers they serve and should also display the registration or license numbers. In addition to these requirements, every insurer or intermediary is also required to follow recognized standards of professional conduct as prescribed by the Advertisement Standards Council of India.

If an advertisement is not in compliance with the aforesaid regulations, the Authority may take action in one or more of the following ways:

issue a letter to the advertiser seeking information within a specific time, not being more than ten days from the date of issue of the letter;

direct the advertiser to correct or modify the advertisement already issued in a manner suggested by the Authority with a stipulation that the corrected or modified advertisement shall receive the same type of publicity as the one sought to be corrected or modified;

20. Id.
• direct the advertiser to discontinue the advertisement;
• any other action deemed fit by the Authority, keeping in view the circumstances of the case, to ensure that the interests of the public are protected.

7. Obligations to the Rural and Social Sector

Every insurer who begins to carry on the business of insurance in India should ensure that he undertakes the following obligations to provide life insurance or general insurance policies, during the first five financial years, to the persons residing in the rural sector\(^{21}\) or social sector\(^{22}\), workers in the unorganised\(^{23}\) or informal sector or for economically vulnerable or backward classes of the society and other categories of persons and such insurance policies shall include insurance for crops.

**Rural sector**

- In respect of a life insurer-
  - (i) 5% in the first financial year;
  - (ii) 7% in the second financial year;
  - (iii) 10% in the third financial year;
  - (iv) 12% in the fourth financial year;

**Social Sector**

- In respect of all insurers
  - (i) five thousand lives in the first financial year;
  - (ii) seven thousand five hundred lives in the second financial year;
  - (iii) ten thousand lives in the third financial year;

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21. See Regulation 2(c), IRDA (Obligations of insurers to Rural or Social Sectors) Regulations, 2000: “Rural Sector” shall mean any place as per the latest census which has
   - (i) a population of not more than five thousand;
   - (ii) a density of population of not more than four hundred per square kilometer; and
   - (iii) at least seventy-five percent of the male working population is engaged in agriculture.

22. See Regulation 2(d), IRDA (Obligations of insurers to Rural or Social Sectors) Regulations, 2000: “Social sector” includes unorganized sector, informal sector, economically vulnerable or backward classes and other categories of persons, both in rural and urban areas.

23. See Regulation 2(c), (Obligations of insurers to Rural or Social Sectors) Regulations, 2000: “Unorganized Sector” includes self-employed workers such as agricultural laborers, bidi workers, brick kiln workers, carpenters, cobblers, construction workers, powerloom workers, physically handicapped self-employed persons, primary milk producers, rickshaw pullers, safai karmacharis, slat growers, sericulture workers, sugarcane cutters, tendu leaf collectors, toddy tapers, vegetable vendors, washerwomen, working women in hills, or such other categories of persons.
(v) 15% in the fifth year  (iv) fifteen thousand lives in the fourth financial year;

• In respect of a general insurer-

(v) twenty thousand lives in the fifth year

(i) 2% in the first financial year;
(ii) 3% in the second financial year;
(iii) 5% thereafter

8. Assignment and Nomination

(a) Assignment

A policy of insurance is a contract of a personal nature and hence cannot be transferred by the insured without the consent of the insurer. In the case of life and personal accident insurances, the subject matter of the insurance is a life and is not amenable to transfer. An assignment of the policy in such cases is just an assignment of the right to receive the proceeds of the policy.

The Insurance Act lays down the mode of assignment and transfer of a life insurance policy. An assignment or transfer may be made only on satisfaction of the following conditions:

(i) an endorsement upon the policy itself or by a separate instrument:
(ii) the endorsement or instrument should be signed by the transferor or his agent and should be attested by at least one witness;
(iv) it should specifically set forth the fact of transfer or assignment.

The aforesaid conditions need to be complied with irrespective whether the transfer or assignment is made without consideration or not. The insurer, on being given notice of the assignment or transfer, shall recognize the assignee or transferee as the only person entitled to the benefit of the policy and such a person shall also be subject to all the liabilities and equities to which the transferor or assignor was subject to.

Additionally, an assignment may be (a) absolute, or (b) conditional that it shall be inoperative or that the interest shall pass to some other person on the happening of a specific event during the lifetime of the person insured, or
(c) in favour of the survivor or survivors of a number of persons. However, the term "policy holder" does not include an assignee whose interest in the policy is defensible or is for the time being subject to any condition, Hence an assignee of a policy subject to any condition shall not be entitled to the rights of a policy holder.24

(b) Nomination

A policy holder of a life insurance policy on his own life has the right, either while effecting the policy or before it matures, to nominate a person to whom the money secured by the policy should be paid in the event of the death of the policy holder. An insurer is not bound by such nomination unless it is brought to his notice, endorsed on the policy and registered in the records of the policy. It is pertinent to note that a transfer of assignment of a policy automatically leads to cancellation of a nomination. Additionally, these provisions relating to nomination under the Insurance Act do not apply to any policies under the Married Women’s Property Act, 1874.25

The Reserve Bank of India ["RBI") is the apex bank of India established in 1935 under the Reserve Bank of India Act, 1934, The Exchange Control Department within the RBI is responsible for the regulation and enforcement of exchange controls. Prior to 1999, India had stringent exchange control regulations under the Foreign Exchange Regulation Act, 1973 ["FERA”). The Foreign Direct Investment (“FDI") regime in India has been progressively liberalized in the nineties with the passage of the Foreign Exchange Management Act, 1999 (“FEMA”), which replaced FERA. Most restrictions on foreign investment have been removed and the procedures have been simplified. Non-residents can invest directly in India, either wholly or as a

24. See Desai Nishith, Supra Note 2.
25. See Section 6(1), A policy of insurance effected by any married man on his own life and expressed on the face of it to be for the benefit of his wife or his wife and children or any of them shall ensure and be deemed to be a trust for the benefit of his wife or of his wife and children or any of them according to the interest so expressed and shall not so as long as any object of the trust remains be subject to the control of the husband or his creditors or form part of his estate.
joint venture. Foreign investment is allowed in virtually all sectors including the services sector subject to Government permission in certain cases.

Insurance companies that are registered with the IRDA, are permitted to issue general insurance policies denominated in foreign currency and are also permitted to receive premiums in foreign currency without the prior approval of the RBI. However, this is permitted only for certain kinds of cases such as marine insurance for vessels owned by foreign shipping companies and chartered by Indian companies, aviation insurance for aircrafts imported from outside India on lease/hire basis for the purpose of air taxi operations etc.

Authorised dealers are also permitted to settle claims in foreign currency on general insurance policies subject to certain conditions such as the claim has been made for the loss occurred during the policy period. The claim is settled as per the surveyors report and other substantiating documents. Claims on account of reinsurance are being lodged with the reinsurers and will be received as per the reinsurance agreement. The remittance is being made to the non-resident beneficiary under the policy etc. However in the case of resident beneficiaries, the claim is required to be settled in rupees equivalent of the foreign currency due and under no circumstances can payment be made in foreign currency to a resident beneficiary.

As per the provisions of the Foreign Exchange Management (Insurance) Regulations, 2000, no person resident in India is permitted to take any general or life insurance policy issued by an insurer outside India. However, the RBI may permit, for sufficient reasons, a resident in India to take any life insurance policy issued by an insurer outside India. However, an exemption has recently been made only for units located in Special Economic Zones ("SEZs") for general insurance policies taken by such units. Therefore, remittances towards premium for general insurance policies taken out by units located in SEZs from insurers outside India are permitted provided that the premiums are paid out of the foreign exchange balances.
A person resident in India but not permanently resident therein is permitted to continue holding any insurance policy issued to him by an insurer outside India, if the premium on such policy is paid out of foreign currency resources outside India. A person resident in India may take a general insurance policy issued by an insurer outside India, provided that before taking the policy he has obtained a no objection certificate from the Central Government of India. Further, a person resident in India is also permitted to continue to hold any insurance policy issued by an insurer outside India when such person was resident outside India, subject to fulfilment of certain conditions.

A foreign company may enter the insurance business in India in either of the following ways:

• **Direct investment in an insurance company**: FDI is permitted in India primarily either under the automatic route, or with prior government approval. Where FDI does not fall under the automatic route, the foreign investor would require the approval from the Foreign Investment Promotion Board ("FIPB"). Indian companies are generally permitted to accept FDI without prior approval, provided that certain sectoral policies and investment limits are met. In the insurance sector there is 26% sectoral cap on FDI, subject to obtaining license from the RCA, which means that a foreign company can invest up to only 26% in an Indian insurance company (calculated in the manner specified in the Insurance Act and regulations there under), while 74% would have to be invested by an Indian company.

• **Branch or Liaison Office**: In the event that a foreign insurance company is not desirous of directly investing in an Indian insurance company, it may, in the beginning, set up a branch or liaison office, subject to the approval of the RBI and/or the Government of India in this regard.  

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26. "Not permanently resident" means a person resident in India for employment of a specified duration (irrespective of the length thereof) or for a specific job or assignment, the duration of which does not exceed three years.
The branch office in India is permitted to undertake only a certain set of activities such as carrying out research work for the parent company, representing the parent company in India etc. A liaison office is also permitted to undertake only a certain set of activities such as acting as a communication channel between the parent company and Indian companies.

9. **Tax Implications**

Insurance companies and insurance agents, in India, are subject to tax for the premiums and the commissions received by them respectively, under the Indian Income Tax Act, 1963 ("Income Tax Act").

The Income Tax Act deals with the computation of the income of the following insurance companies:

- Companies carrying on life insurance business which are resident in India;  
- Companies carrying on any other kind of insurance business, which are resident in India; and  
- Non-resident persons carrying on the business of insurance in India through a branch.

There is no recognized business method of ascertaining the profits derived from life insurance business. This would depend on the actuarial calculations and valuations.\(^27\) The Income Tax Act lays down provisions with respect to the income received by an assessee from the business of insurance whether the company which receives such business income is resident in India or not. These special provisions exclude the operation of other sections under the Income Tax Act dealing with computation of income. Therefore, the profits and gains from the insurance business are to be computed artificially in accordance with these rules.\(^28\) The First Schedule of the Income Tax Act overrides the other provisions relating to computation of income under separate and distinct heads of income. The income is therefore, not to be

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\(^{27}\) See CIT v. Great Eastern, 17 ITR 173.  
\(^{28}\) See Bombay Mutual v. CIT, 20 ITR 189.
computed under the different heads and in accordance with the provisions of
the Income Tax Act, but the income from all the sources should be computed
as one figure on the basis laid down in this schedule.

The profits and loss of a person carrying on the business of insurance
are to be computed separately from the profits and gains from any other
business. Though the profits of life insurance business are to be computed
separately from the profits of non-life insurance business or other business
carried on by the assessee, any loss incurred in life insurance business can be
set off against profits of non-life insurance business or other business. In
computing the profits of life insurance business, the profits and gains of the
business is taken to be the annual average of the “surplus”. This surplus is
arrived at by adjusting the surplus or deficit disclosed by the actuarial
valuation made in respect of the last inter-valuation period ending before the
commencement of the assessment year. The tax payable, computed in the
manner stated above, will be reduced by tax withheld at source for income
from interest on securities in respect of annual average of income tax. In
computing the profits of any business other than life insurance, the profits
and gains is taken to be the balance of the profits disclosed in the annual
accounts.

In case of non-resident companies carrying on the business of
insurance in India, in the absence of reliable data, the profits and gains is
taken to be that proportion of the world income which corresponds to the
proportion of the premium income derived from India.

A branch of a foreign insurance company is subject to income tax at the
rate of 42% [including 5% surcharge on tax) while a subsidiary of a foreign
insurance company is subject to tax at the rate of 38.75% (including 5%
surcharge on tax).

The Finance Act, 2002 has brought insurance within the service tax net.
The insured is thus liable to pay service tax at the rate of 5%.
Taxation of Life Insurance companies

The Income Tax Act, 1963 provides that the income tax payable on the profits and gains arising from the life insurance business will be calculated at the rate of 12.5% of such profits and gains. An insurance company is required to deposit an amount equal to one-third of the tax, in a Social Security Fund as notified by the Central Government. Further, the insurance company is required to deposit an amount of not less than 2.5% of the profits and gains of the insurance business in such a Security Fund. Where the insurance company has deposited such an amount, the income tax payable by the insurance company will be reduced by that amount and the amount to be deposited in the Security Fund would also be calculated on the income tax so reduced.

Taxation of Commission to Insurance Agents

The Income Tax Act has laid down provisions for the taxation of insurance commissions. Insurance Commission has been defined to mean any income (remuneration or reward) by way of commission or otherwise for soliciting or procuring insurance business. The effect of the provision is that any person responsible for paying any such income to a resident individual will be required to deduct income tax at the prescribed rates. The provision applies only in the event that the individual is a resident of India. This provision is not applicable for an individual who is not a resident of India. Tax for such payments made to a non-resident will have to be deducted under in accordance with the provisions of Section 195 of the Income Tax Act.

10. Stamp Duty

An insurance policy needs to be duly stamped in accordance with the stamp duty prescribed for each kind of policy under the Indian Stamp Act, 1899 ("Stamp Act"). The rates of stamp duty on insurance policies are the same throughout the territories of India. Generally, the stamp duty on a life insurance policy or group insurance is borne by the person effecting the insurance. In the case of a fire insurance policy, the insurer is liable to bear the
stamp duty. Non-payment of stamp duty, is a punishable offence with a fine which may extend up to rupees two hundred if an insurer receives the premium for an insurance policy and does not execute a policy or executes a policy which is not stamped. 29

Functions and Duties of the Regulator

With the passing of the Act, 1999, all the powers enjoyed by the Controller of Insurance are now vested with the IRDA. The chairman of the IRDA is now again the chairman of the Tariff Advisory Committee (TAC). The Act lays down duties, powers and functions of the authority.

The duties, powers and functions of the authority are:

(a) Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
(b) Protection of interests of the policyholders in matters concerning assigning of policy, nomination by policyholders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
(c) Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;
(d) Specifying the code of conduct for surveyors and loss assessors;
(e) Promoting efficiency in the conduct of insurance business;
(f) Promoting and regulating professional organizations connected with the insurance and reinsurance business;
(g) Levying fees and other charges for carrying out the purposes of the Act;
(h) Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business;
(i) Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business

29. See Section 2 (19-A), Indian Stamp Act, 1899: “policy of group insurance” means any instrument covering not less than fifty or such small number as the Central Government may approve, either in consideration or a premium paid by an employer or by an employer and his employees jointly, engages to cover, with or without medical examination and for the sole benefit of persons other than the employer, the lives of all the employees or any class of them, determined by conditions pertaining to the employment, for such amount of insurance based upon a plan which precludes individual selection.
not so controlled and regulated by the Tariff Advisory Committee under Section 64U of the Insurance Act, 1938;

(j) Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;

(k) Regulating investment of funds by insurance companies;

(l) Regulating the maintenance of a margin of solvency;

(m) Adjudication of disputes between insurers and intermediaries or insurance intermediaries;

(n) Supervising the functioning of the Tariff Advisory Committee;

(o) Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations referred to in Clause (f);

(p) Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and

(q) Exercising such other powers as may be prescribed. Insurance Regulatory and Development Authority Act, 1999; Section 14, (2) Duties, Powers and Functions of Authority.30

The powers conferred on the IRDA enable it to specify requisite qualifications for intermediaries and agents; to specify the code of conduct for the surveyors and loss assessors; to levy appropriate fees for carrying on this business; to call for information from and conduct inspection or inquiries of organizations connected with insurance business, etc. The IRDA also has powers to control and regulate rates, advantages, etc., in respect of the general insurance business where it is not so controlled or regulated by the TAC; to regulate investment of funds by insurance companies; to regulate the maintenance of solvency margins; and to supervise the functioning of the TAC.

The authorities also have substantial powers to deal with cases of non-compliance with the directions issued by the IRDA from time to time, or with the provisions of the Act. It is authorized not only to levy heavy penalties, but can also cancel the registration of insurers in the case of serious offences.

Costs of regulation will naturally have to be borne by the consumer in some form or the other. The Malhotra Committee had suggested that in the

interest of the autonomy, the Insurance Regulation Development Authority (IRDA) should have an independent source of financing its establishment and activities. This, the committee thought, could be best achieved by a small levy, say 0.05 per cent of the yearly premium income of insurance companies. The Act has the following provision with regard to setting up of a fund to meet the IRDA’s responsibilities.

- The fund is to be known as ‘the Insurance Regulatory and Development Authority Fund’, to which the following monies are to be credited that is, all government grants, fees and charges received by the authority; all sums received from any other source decided by the government; and a percentage of the prescribed premium income received from the insurers.

- The registration fee is Rs 50,000. For renewal, the fee prescribed is Rs 50,000 and one-fifth of 1 per cent of the total gross premium during the relevant financial year or Rs 50 million, whichever is less.\(^{31}\)

It appears that the IRDA proposes to introduce multi-point control rather than a single-point control. Such a system attempts to intervene at different points like product pricing, expenses investment pattern, surplus determination and distribution, whereas a single-point control system concentrates on the valuation of assets and liabilities together with adequacy of funds to meet the reasonable expectations of policyholders even under adverse conditions.

One anxiety that is often expressed relates to the viability of the insurance companies. There is a fear that after collecting large funds in the beginning, the companies may not find it easy to meet their commitments, and would, as a result, try to close down their business. In order to overcome this fear, stringent exit restrictions have been laid down in the Act to protect the interest of the consumers.

**Responsibilities of the Regulator**

A regulatory authority has to shoulder heavy responsibilities and has to perform a difficult role. On the one hand, it has to guard against

\(^{31}\) See Insurance Regulatory & Development Authority Act, 1999, Sec 16
malpractices and on the other, it has to impose restrictions in a manner by which the normal working, the progress and growth of the industry are not hampered. The regulator has to monitor the flow of information and adherence to legal and accounting standards and should feel confident that the companies under its supervision are performing sufficiently as well. While monitoring the entry of new players, it has to ascertain that they have probity, adequate professional capability and financial solvency.

Other important aspects would be an emphasis on premium control, fair premium rates, approved policy wordings, control of investments and continuing audit and intervention, equitable allocation of profits between policyholders and the company, and between different groups of policyholders, good return for money and speedy settlement of claims. Equally, full disclosure of the financial affairs of the insurer and transparency in his transactions, have to be insisted upon because the common man's money is involved.

The credibility of the regulator must be high and it is necessary that the policyholders have access to full information, so that they themselves can make well-informed decisions. The regulator must ensure, for the consumer, enough choice of sources and products and better service, possibly through competition among the providers. While ensuring fairness in competition and a level playing field for the new entrants, the regulator has also to ensure that the nationalized companies are treated at par with new players in terms of freedom to take commercial decisions.

Failures of insurance companies could arise on account of one or more of the following factors: (a) inadequate pricing; (b) improper method of reserving; (c) poor/inappropriate investment strategy; (d) failure to maintain adequate solvency margin; (c) poor underwriting and claims control; (f) uncontrolled growth of the company's business; and/or (g) inadequate control system and efficiency.
Thus, the aforesaid are the causes over which the companies have a good control. However, there are some external factors over which the companies do not have adequate control, such as: (a) bad claims experience; (h) high inflation in claims and expenses; (c) business losses and lapses of policies; (d) failure of third parties such as reinsurers, brokers/agents; (e) adverse movement in asset values; (f) catastrophes; (g) adverse market situations; (h) legislative changes; (l) taxation policies; and/or (j) delayed and unanticipated claims.

It is therefore, submitted that the regulator has to be alert about these possibilities and must have a system to produce alarm signals in advance to be followed by timely precautionary action to deal with them. Lastly, the regulator has to ensure capital adequacy of insurers in order to be able to cover the risk of adverse events, asset failure, liability underestimation, reinsurance failure, excessive expenses and temptation to write new business at inadequate premium rates. Imposing capital requirements can be a simpler mechanism than waiting to see if claims can be settled.
B. Under Islamic Legal System

The basic object of takaful is to bring equity to all parties involved in takaful contract. Profit earning is not the prime objective, but rather the aim is to help others who face risks and share misfortunes. In takaful contract there are four parties involved i.e.:

(a) The Participant  
(b) The Operator  
(c) The insured  
(d) The beneficiary

The contributions or premiums made by the participants are put into two separate accounts, one of them is an investment account that follows the principles of Mudarbah (profit & loss sharing) and the other account is treated as charity or a donation according to the principles of tabarr'u.

Framework and Object of Takaful Operations:

To fulfill its unique mission takaful is framed in such a way that policyholders remain the owners of the takaful risk pool, similar to a mutual insurer or a mutual fund. Ideally, policyholders participate in the management and the decision making related to the working of the takaful company through a members committee or representation on the Board of Directors. The entire object of takaful is self-sustaining operations, not profit maximization. Participants agree to give up a portion, of their contribution as aid to other members in the event another policy holder suffers injury, damage, loss or catastrophe befalls him. After reconciliation of accounts, any annual operating surpluses if remain are redistributed back to the members or reinvested to strengthen the risk pool's capital reserves.

All takaful business activities are required to be performed in compliance with Sharia'h principles and its prescriptions. As such no coverage is issued on prohibited activities such as gambling, alcohol, pork, armaments, tobacco. These are the investments made to earn, unlawful profits
according to Sharia’h law i.e. through usury, interest and debt securities that involved riba. Takaful activities are governed by Islamic ethics including; fair pricing, no injury to either party, clear and well defined agreements, full disclosure and fair dealings. Hence a takaful company can neither support nor invest in other companies where business dealings are against the teachings of Islam. Hence, every takaful operator has to establish a Sharia’h advisory or Supervisory Board of qualified Sharia’h scholars to ensure Sharia’h Compliancy of the operations at all times.32

The takaful principles are illustrated below, explaining the relationship between the participants and the operating company managing the takaful pool of funds:

**Sharia’h Advisory Board**

SHAREHOLDER’S FUND
(Capital Reserve)

Claims: Loss & Damage Coverage

PARTICIPANTS (Policyholders) ——> FUND ——> SURPLUS
(Income or Return)

(Fig) Takaful Basic Principle

**How the Takaful System works:**

The operational structure of a takaful company as applied in Malaysia, Bahrain and Saudi Arabia is one in which the general manager is the chief manager of a takaful company and a company has four departments under his supervision each covering a specific area.

**General Manager** - Generally in a takaful Company, the general manager has a duty to control four departments, that is, family takaful, general takaful, finance and administration and marketing. He has the overall responsibility to implement organizational plans, and to achieve organizational goals. He also has full authority to make decisions for all the departments under his control.

**Family Takaful Division** - Family takaful schemes have been grouped into two classes, an individual takaful and a group takaful. In an individual takaful the participant has a policy to protect himself/herself for security against defined risk. A legal operator will manage the premium paid by the participants. The operator has responsibilities to gain collective rights over contributions and benefits. All these activities will be treated according to the principles of *Mudarbah*, that is, profit and loss sharing in a participant’s account, while in the Participants Special Account (PSA) it will be treated in line with the principles of *al-tabarr'u* (charity). For example, Syarikat Takaful Malaysia Berhad provides many products for individual plans, family takaful plans for education, Takaful Rawat, Takaful Mortgage, Takaful Keyman, Takaful Siswa, Takaful Waqf etc.

In a group takaful, a participant will have the policy for a group that is his own and also his family, as a protection for them from any defined risk. Similar to an individual takaful, a legal operator will manage the funds. As an example, in group plans in Syarikat Takaful Malaysia Berhad, it provides Group family takaful plan and Group Medical Takaful plan.

**General Takaful Division** - In this division, all operations are managed by the functions of underwriters and are usually grouped in to three categories: Underwriting, claim and retakaful. The underwriter has a responsibility to arrange the terms and conditions of the cover and its price, at all levels which reflect the degree of risk and the case is putted in to the general takaful fund by way of potential frequency and potential security and loss. The takaful
underwriter must also ensure that the one who proposes has the capacity to contest and is compliance with Sharia’h law.

**Finance and Administration**- Finance and administration is very important for any company, for it to be able to manage the business successfully. For that reason, the takaful company has these two departments to make management easily controllable, and to trace the problem quickly.

**Finance**- The finance department itself is divided into two parts that is investment and account. Under the account division, the first is a shareholder fund where the entire premium is paid by the participants will be collected and managed by a legal operator for a legitimate consideration for the services given. Secondly, the family takaful fund, which is collected through the contribution made by the participants, is put into two accounts i.e. participants account, where fund is invested according to the principles of *Mudarbah* (profit and loss sharing) and participants special account, which is treated as a charity according to the principles of *al-tabarr’u*. Lastly there is a General takaful fund, which is treated on the basis of *al-tabarr’u* in a participant special account.

**Illustration** - X has a family takaful policy for the right to claim from the operator the total amount of paid contribution together with a share of the profits made over the contribution. In addition, he will also get a bonus and dividend according to the company’s policy. But if X dies before the maturity of the certificate, the nominee shall have the right to claim the total paid contribution and share of the profits made, bonus and dividend which he will receive based on the company’s policy and also a donation from the company’s *al-tabarr’u* fund. Then nominee (B) will give all that money to X’s legal heirs.

Furthermore, the other part of the finance division, which is investment, is responsible for investing all the contributors paid by the participants to gain profits. These profits will be distributed to participants
and also operators based on the principle of Mudarbah. But if it incurs a loss, only participants will bear the losses.

**Administration**- This is the part of a company where all matters concerning a takaful company must be reported and recorded. The administration department is also known as the Human Resource Department, where it is classified into three specific areas: branch operation, general administration and personnel and training.

Branch operations highlight any matter or problems of a takaful company's branch or outlet. All managers at every outlet must refer to headquarters about any problems arising, especially management problems, before making any changes or decisions. General administration acts as the main management office where all information’s, problems and any matters to do with business are discussed and kept. For instance, information is kept about participants personal details.

A takaful company needs good trust (amanat) and well trained people as operators who will manage the entire funds paid by the participants. Therefore, a takaful company has a special division which provides training and takes care of employee’s welfare; this division is called the Personnel and Training division which will provide for the training of the employees. For ex. special training is given to new operator to work effectively and efficiently with regard to the takaful operations.

**Marketing**- A takaful company needs a marketing department to plan and promote all the products and services it provides to make it more effective and efficient. The marketing department is divided into two areas, using an agency to help them promote their products, and corporate marketing for the company itself. Nowadays, the marketing department of a takaful company promotes the company and its product through the internet. For example, Syarikat Takaful Malaysia Berhad (a takaful operator) has its own website,
www.takaful-malaysia.com.my, where all information about the company and products provided by the company is given.33

**Takaful Models**

Any form of insurance business acceptable to Islam must contain the virtues of cooperation, solidarity and *Tabarr'u*. Sharia'h scholars are also unanimous that there can be a commercial basis of conformity with regard to the basic characteristics of Islamic business principles. Towards this end, the scholars have suggested from time to time various models of takaful. Takaful models aim to produce an increase in the total value of initial capital (i.e. investment) applied to establish the takaful operations. Certain Muslim countries have chosen a “pure” non-profit model for takaful (as in Sudan for example), while other countries have elected to pursue for a profit model, more commercial version of takaful (such as Malaysia, Bahrain and the UAE).

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**Non-profit Model**

The chief proponent of non-profit model is Sudan. All premiums from policyholders are treated as a donation (*tabarr'u*). Members do not expect to receive any returns from their donations, but in case of loss a “charitable”

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contribution is given from the takaful pool of funds in the event of a covered loss up to the available limits of the funds.

Since the takaful fund is owned by the policyholders, there is no separation between shareholders and policyholders fund. Thus, all investment returns on invested premium are folded back into the takaful pool of funds and belong only to the policyholders. As this model is not geared up for profit making, the premiums may fluctuate up or down to track the anticipated funds required to cover the estimated losses. A management committee, elected among the policyholders, shares decision making and controls operations. Theoretically, non-profit takaful associations have formed the preferred foundation for Islamic risk protection and insurance due to host country situations and varying regulatory environments. Not all takaful companies have strictly adhered to a theoretical model of non-profit operations. Several countries have opted insurance regulatory mechanism for profit operations that are more commercially driven nowadays.

**Ta‘awuni Model: (Cooperative Insurance)**

The concept of ta‘awun originated in Sudan and Saudi Arabia. It was first established in 1979, when scholars realized that there is a need for cooperation in insurance. From this came the idea that members should donate their contribution to the fund. Both the operators and the contributors acknowledge their rights and responsibilities to the fund. The profit surplus is to be distributed entirely to the participants.

Under the *Mudarbah* principle, the takaful company and the participants share the direct investment income, in which participants are entitled to the entire surplus with no deduction made prior to distribution. This model is applicable to life family takaful as the fund is entirely distributed to the participants.

**Example:** An individual lends his money to a takaful operator who manages the fund on behalf of the participant. Islam tells us to help one another so long as it does not violate the rulings of Sharia‘h:
"And co-operate ye with one another in righteousness and piety..."\textsuperscript{34}

The contribution is based on the principles of tabarr'u. A tabarr'u concept is a one-way transaction in which, once the contribution is made, the contributor has no right to take any benefits out of it. The fund is used for any participant who faces difficulties with in the time period as agreed upon in the insurance policy. When the participant contributes to the fund, he is indirectly applying the golden principle of “bear ye one another’s burden”.

Each contributor in ta’awun practice will share the profit, liability, indemnity and surplus and will receive equal benefits and advantages. For example suppose a member of a takaful fund meets with an accident and claims for indemnity to repair his car that costs him Rs. 1000. In this case, he will be entitled to receive his compensation. The purpose of takaful company is to help and assist the participants in reducing the losses due to unexpected misfortune or disaster.

Example of calculation of takaful fund under ta’awuni model:

**1. General Takaful:**

```
<table>
<thead>
<tr>
<th>Contribution</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>80% Allocation</td>
<td></td>
</tr>
<tr>
<td>20% surplus</td>
<td></td>
</tr>
</tbody>
</table>
```

- Underwriting surplus
- Claim reserve
- Re-takaful
- Unearned premium
- Management cost
- Technical Reserve

After the deduction of the allocation, the participant will get the entire surplus.

\textsuperscript{34} V: 3
2. Family Takaful:

The above figure shows the accounting flow in ta’awuni model. The ta’awuni model produces no issues pertaining to the participant account (PA) and participants special account (PSA), because the proportion is equally divided 50:50. The fund in PA will be used for long term investment and profits gained from investment will be shared among the family members. Meanwhile in PSA, the fund is viewed as a donation or sadaqah, intended to help the needy and the suffering. Suppose the premium paid by the participant is Rs. 200 and it will be divided in two, for PSA and PA. For PSA, Rs. 100 attributed to PSA will be deducted as business expenses. On the other hand, for PA, the Rs. 100 will be used for underwriting surplus. Underwriting is best described as an insurable risk. The role of the underwriter is to decide whether to accept or reject the application for insurance. This is important in order to maintain a safe and profitable distribution of business for the company. The money will be invested in the project in conformity with
Sharia’h and the gains will be distributed between the participant and the takaful operator, 50:50.

For the Rs. 40 in the participant’s part, the money is reserved for those participants who did not make any claim during the period. For the operator’s part, the Rs. 40 will be subtracted for management expenses, for example staff cost, maintenance, establishment expenses and administration general expenses, the remained will then be subtracted from the Zakat family fund. In the end, the balance is actually the net profit for the operator or the shareholder.\textsuperscript{35}

**Profit Model**

There are four types of takaful model under profit model: the *Mudarbah* based model, the *Wakalah* based model, the *Wakalah Mudarbah* based model and the *Wakalah Waqf* based model.\textsuperscript{36}

1. **Mudarbah Model:**

   *Mudarbah* is a partnership in profit whereby one party provides capital (rab-al-maal) and the other party provides labour (Mudarib).

   The *Mudarbah* model is based on classic profit sharing principle, i.e. a partnership model where the participants provide the capital, while the takaful operator provides expertise and management of the takaful fund in return for a share of surplus on underwriting and a share of the profits from the investments. In this model takaful operator does not take any risks or shares in any losses. He only risks his services and labour. However if there are substantial losses to the risk pool resulting in deficit, the takaful operator is typically contractually bound through policy terms to provide an interest free loan (qard hassan) that should be repaid when the risk pool returns to


\textsuperscript{36} See Kassar Kaheld, *op. cit.*, pp. 53-54.
surplus (profitability) and before any future surplus may be distributed to policyholders.\textsuperscript{37}

In line with the rules of Mudarbah, administrative expenses related to the conduct of investments are charged to the takaful operator company and hence born by the shareholder’s fund. The expenses charged for operations, general and administrative expenses of the entire business are charged to the policyholder’s fund. In Mudarbah model takaful benefits are paid to beneficiaries as and when claims are made. At the end of the year, depending upon occurrence of actual losses and damages, policyholders may receive an insurance surplus. If any or may be required to make additional payments if a deficit results. Typically, the surplus is shared with the takaful operator on a ratio declared in advance.

**Earning of Profit under Mudarbah Model**

The takaful operator’s income derives from a pre-set share of the investment income and a pre-set share of the underwriting surplus. He gains profit when his income exceeds expenses. Each participant agrees to these percentage fees when the takaful contract is signed. The role of shareholders capital is to meet the administrative expenses of running the company, and where necessary, to provide a qard hassan in case of a short falls in the funds of the risk pool.\textsuperscript{38}

\textsuperscript{37} See Tobias, Frenz, Madhu, Sridharan and Iyer Krishna, “Developing a Takaful Product in India- Risk and Challenges”, 10\textsuperscript{th} Global Conference of Actuaries organized by Institute of Actuaries of India, Mumbai on 7\textsuperscript{th} & 8\textsuperscript{th} Feb, 2008.

\textsuperscript{38} See Kassar Kahled, op.cit, pp. 55-56.
Figure - 1: Mudarbah Model

Features of Mudarbah Model

1. The Mudarbah model was introduced in Malaysian Market in 1984 and also known as Malaysian model of insurance.

2. The participant’s role is as the rabb-al-maal (capital provider).

3. The operator’s role is as the Mudarib (entrepreneur).

4. The takaful (tabarr'ut) fund belongs to the participants.
5. Profit is shared between the participants and the operator in a pre-agreed proportion.\textsuperscript{39}

\textbf{Kinds of Mudarbah}

There are two kinds of \textit{Mudarbah} Model i.e.:

1. Unrestricted \textit{Mudarbah} model
2. Restricted \textit{Mudarbah} model

1. \textbf{Unrestricted Mudarbah Model}

An unrestricted \textit{Mudarbah} model is a contract in which the capital provider permits the Mudarib to administer a \textit{Mudarbah} fund without any restrictions.

In this case, the Mudarib has wide range of trade or business freedom on the basis of trust and the business expertise he has acquired. An example of unrestricted \textit{Mudarbah} is when the capital provider says, “Do business according to your expertise”. However, such unrestricted business freedom in an unrestricted \textit{Mudarbah} must be exercised only in accordance with the interests of the parties. Therefore, the actions of the Mudarib must be in accordance with the business customs relating to the \textit{Mudarbah} operations.

2. \textbf{Restricted Mudarbah Model}

A restricted \textit{Mudarbah} model is a contract in which the capital provider restricts the actions of Mudarib to a particular location or to a particular type of investment as the capital provider considers appropriate, but not in a manner that would unduly constrain the Mudarib in his operations.\textsuperscript{40}


\textsuperscript{40} Study Material by Accounting and Auditing Organization for Islamic Financial Institutions, p. 236.
Example of calculation of general takaful fund under Mudarbah model:

<table>
<thead>
<tr>
<th>Contribution paid</th>
<th>Rs. 200</th>
</tr>
</thead>
<tbody>
<tr>
<td>(-) Management costs</td>
<td>Rs. 100</td>
</tr>
</tbody>
</table>

- Retakaful
- Unearned contributions
- Technical Reserves
- Incurred but not reported
- Claim reserves

Underwriting surplus Rs. 100 → Belongs to company

No claim? → invested

Balance

\[ \text{Mudarbah Profits/ BONUS} \]

Distributed

Under Mudarbah Model of general takaful fund the contributions paid are regarded as "al-tabarr'u". Therefore the participants have no right to claim the fund since it is already treated as donation. However if they are based on defined risk of the subject matter, the participants can claim their rights. The deduction made is for allocation costs, that is retakaful, claim reserves, technical reserves, IBNR and unread contributions. It is noted that Mudarbah Model is based on a business instead of a service charge.

All contributions paid by participants are directly deducted for allocation. The balance left is the operator's responsibility and the term given is the amount of underwriting surplus. The underwriting surplus is invested in lawful investment projects if there is no claim made by donors under the principles of Mudarbah financing technique. The profit from the investment
will then be distributed accordingly between the Mudarib (takaful operator) and the rabb al maal (capital provider).^1

Example of calculation of family takaful fund under Mudarbah Model:

Contribution paid Rs. 200 — 95% (Participant Account)

- Shared by shareholder and participants
  - Who do not make a claim
  - 5% (Participants special Account)
    - (-) Allocation costs
    - Underwriting surplus
    - Balance shared by shareholder
    - Tabarr'u fund

Under Mudarbah Model of family takaful fund there are two different accounts involved, the PA (participant’s account) and the PSA (participant’s special account). The PA is managed according to the principles of Mudarbah financing under the profit and loss sharing technique. It means that any profit gained from the lawful investment will be shared according to an agreed ratio between the shareholder and the participant. The scenario will be slightly different in terms of loss in which only the participants bear the incurred loss and shareholders will receive nothing from the services rendered.

For the PSA account, the tabarr'u principles are applied and for that reason also, the participants are not allowed to make any claim if there is no risk incurred within the maturity period of the takaful policy. After deducting the allocation costs, the remaining (underwriting surplus) will be invested in business in conformity with Sharia'h. The amount left is allocated between the shareholder and the tabarr'u fund.^2

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42. Id.
Concerns Regarding *Mudarbah* Model

1. The basic concern is the application of *Mudarbah* or “Profit sharing” contract to a takaful operations and sharing of surplus by the operator and the relationship between the participants is that of *tabarr'ū* and not of *Mudarbah*.

2. In a *Mudarbah* contract, profit is generated to be distributed. Profit is not the same as “surplus” and in insurance context no profit is to be generated by definition.

3. The sharing in surplus itself is something which is similar to making this into a business venture and not a mutual contract for assistance.

4. The requirement to provide Qard Hassan (in case of deficit) in a *Mudarbah* contract in itself is against the concept of *Mudarbah* which is a profit sharing contract and a Mudarib cannot be a guarantor.\(^{43}\)

The important issue in this model is that the amount donated as "*Tabarr'ū*" cannot simultaneously become capital for the *Mudarbah* relationship. Moreover the takaful operator gets the underwriting surplus (UWS), but does not bear the underwriting losses (UWL). Therefore, Sharia’h scholars have raised serious objections to this model.

2. **Wakalah Model**

In the Wakalah Model (contract of agency), the takaful operator acts as the agent of the policyholders and receive a declared remuneration that may be an absolute fixed amount of money’s or a percentage of the gross contribution (premium) collected from policyholders make contributions consisting of two parts (a) Wakalah fees and (b) *tabarr'ū* risk sharing donation, that is credited to a policyholder’s fund. The takaful company assumes the role of an agent or wakil of the policyholders backed by shareholders who

have contributed capital to a shareholder’s fund that is managed separately from the policyholder’s fund.

The takaful operator invests the policyholder’s fund in Sharia’h compatible assets and investments in its capacity as agent or wakil. Profits generated from investing, less fee, add to the policyholder’s fund. Certain sales, operational and administrative expenses are retained by the takaful operator and covered by the Wakalah fee charged to the policyholder’s takaful contribution. Selected operational direct expenses [i.e. claims processing, adjusters, medical laboratory expenses] may be charged to policyholders. Contribution by the operator is included with the Wakalah fees. Takaful benefits are paid to beneficiaries as and when valid claims are made. At year end, depending upon occurrence of actual losses and damages, policyholders may receive the takaful surplus, if any, or in some Wakalah models the surplus may be reduced by payment of an incentive fee to the takaful operator. This model is mainly used in Middle Eastern and African countries.

**Earning of Profit under Wakalah Model**

Most expenses of this model are circumscribed by the Wakalah fees which are disclosed to each participant upon signing the takaful contract and charged up front. Although the risk premium is loaded with the Wakalah fees, once the contract is set, the contribution paid regularly by policyholders does not change. Hence, an operator must manage his responsibilities and overall takaful operations within the expected income in order to generate profit; otherwise shareholders may experience negative earnings even though the policyholders fund may be in surplus. Some scholars have permitted a Wakil to benefit with an incentive fee allocated to policyholders annual surplus which then forms an additional income source to the operator, when and if surplus results.44

44. See Kassar Kahled, *op. cit*, pp. 58-59.
Features of Wakalah Model

1. This model began its development in Sudan and the Middle East.
2. The takaful operator is compensated by a pre-agreed fee.
3. The participant’s role is as the principal.
4. The operator’s role is as the Wakil (agent).
5. The takaful (tabarr'u) fund belongs to the participants.
6. The operator does not share in the underwriting surplus, but instead is compensated by a fee deducted from the contribution at the outset of each contract.⁴⁵

Example of calculation of general takaful fund under Wakalah Model:

\[ \text{Premium paid} \rightarrow \text{Rs. 200} \]
\[ \text{(-) Management costs} \rightarrow \text{Rs. 100} \]
\[ \text{(-) Allocation costs} \rightarrow \text{Rs. 100} \]
\[ \text{Underwriting surplus} \rightarrow \text{Rs. 50} \]
\[ \text{Profit from investment is divided in half} \]
\[ \frac{50\%}{\text{Shareholders}} \quad \text{and} \quad \frac{50\%}{\text{Participants}} \]

This example illustrates Wakalah model of general takaful fund. ‘A’ is the takaful operator, ‘B’ works as an agent or Wakil and represents A and C as participants or policyholders of the takaful business. In this model C is obliged to pay his contributions to A. However C could give his contribution to B as B has been authorized to collect the contributions from C as well as other participants. The contribution collected will then be pooled into the takaful fund. The fund will be managed by A, according to the principles of Mudarbah and tabarr'u. Thus it can be concluded that all participants are actual owners of the fund. In the case of general takaful fund if A wants to start managing funds under this model, A will first deduct some amount from the participants special account (PSA) on the basis of tabarr'u for management and services expenses. The remaining balance will be deducted to allocate
costs. Unearned contributions, claims, reserves, technical reserves, retakaful cost and incurred but not reported. The balance is called underwriting surplus. This surplus will be used for investment that is not violating the rulings of Sharia'h. Profits obtained will be distributed between the shareholder and participants who have not made any claim during the time period. Normally it will be allocated equally 50:50.  

Example of calculation of Family Takaful fund under Wakalah Model:

Contribution paid \hspace{1cm} \text{Rs. 200}

(-) Management Cost \hspace{1cm} \text{Rs. 100}

\begin{align*}
\text{Rs. 100} & \quad \rightarrow \text{Participants account (investment account)} \\
\text{\hspace{1cm} -95\%} & \\
\text{(Accumulated contribution + profit)} & \\
\text{\hspace{1cm} \rightarrow \text{Participant's special account}} & \\
\text{\hspace{1cm} (Risk management account)} & \\
\text{\hspace{1cm} -5\%} & \\
\text{(For allocation costs)} & \\
\text{\hspace{1cm} - Retakaful} & \\
\text{\hspace{1cm} - Unearned contribution} & \\
\text{\hspace{1cm} - Technical reserves} & \\
\text{\hspace{1cm} - Incurred but not reported} & \\
\text{\hspace{1cm} - Claim reserves} &
\end{align*}

Under Wakalah Model of family takaful fund two types of accounts are involved in this fund, Participants Account (PA) and Participants Special Account (PSA). It is up to the operator, A to manage both accounts according

\[46. \text{ See M. Hassan Kabir and Lewis K. Mervyn, op. cit, pp. 411-412.}\]
to the principles of *Mudarbah* and *tabarr'u*, respectively. The fund pooled from the contribution will then have management costs deducted. The balance from this amount is separated into participants account and Participant special account.

For participants account, when no claim is made by B, he/she is entitled to receive an accumulated contributions paid together with profits. However, participants are not entitled to any benefits from participant’s special accounts as they are earmarked for various business expenses.47

**Concerns Regarding Wakalah Model**

1. Under Wakalah Model, the *tabarr'u* (donation) remains the property of the participant as he has the right to receive the surplus back and therefore becomes conditional.

2. Further this gives rise to the issue such as inheritance in the case of death of the person as the donation is a conditional gift.

3. The relationship is between the participants and the operator and also amongst the participants which give rise to a contract of compensation.

4. Qard Hassan is an obligation on shareholders which would be returned by future generations which would be different.48

These concerns are less serious and it is required to find solutions to these issues within the Wakalah Model as in principle this model has been seen as more acceptable by scholars as the issues within *Mudarbah* model are much more serious from a Sharia'h perspective.

3. **Wakalah Mudarbah Model**

A combination of both models is common where a Wakalah applied on underwriting and a *Mudarbah* on the investment profit for family takaful products. That is, the operator charges a Wakalah fee from the takaful contributions and all underwriting profits are distributed to the participants.

47. Ibid, p. 413.
48. See Wahab Abdul Rahim Abdul, See Supra note 40
But investment profit is shared between participants and the operator based on a pre agreed ratio.

Figure - 3: Wakalah Mudarabah Model

This model has its appeal as investment profits are usually the major source of income; underwriting results can easily be managed using quota share retakaful arrangements. From the takaful operator's perspective, this model avoids the Sharia'h disputes on Mudarba in underwriting but allows for equivalent commercial results. It has the potential to combine the advantages of both standard arrangements for takaful operators. The flip side
of this coin is that it also has the potential to maximize the governance issues from the participants’ perspective. 49

**Concerns Regarding Wakalah Mudarbah Model**

Under the combined model, the sharing of profit between participants and operators is an entitlement embedded in the contract i.e. underwriting surplus (UWS) and the investment profit both are shared. There is, however a structural issue in the way such profits/surplus is determined. The issue is that, under Mudarbah, the operator as Mudarib, cannot charge its management expenses from the takaful fund separates from its share as Mudarib, whereas under Wakalah, the operator being the agent of the participants, can take its management fees from the fund as per pre-agreed terms. Further, the operator does not bear the underwriting loss. Therefore, it also smacks of trouble from the Sharia’h angel. 50

4. **Waqf Takaful or Wakalah with Waqf Model**

Recent developments among takaful operators have resulted in a new hybrid model emerging in South Africa and Pakistan Wakalah Waqf. A Waqf is a trust or public endowment which is operated generally on a non-profit basis as a custodian of funds for members or “owners” of the Waqf fund.

A Waqf fund would basically be a separate legal entity to which the shareholders would initially make a donation to establish the Waqf fund. The donation can be of any reasonable amount. The objective of the Waqf fund would be to provide relief to participants against defined losses as per the rules of the Waqf fund. A Waqf based Model flow has been illustrated below:

49 See Tobias, Frenz, Madhu, Sidharan and Iyer Krishna, Supra note 34.
In this modified Wakalah model with Waqf, the relationship of the participants and of the operator is directly with the Waqf fund. The operator is the Wakil of the Waqf fund and the participants pay one sided donation to the Waqf fund which also eliminates the issue of Gharar. The Waqf fund rules may define the staring of surplus and other rules under which it would operate but there is no obligation to distribute surplus. Further the Qard would be given by the shareholders to the Waqf entity and not to individuals as in the typical Wakalah model.
The donations received from the participants, seeking takaful protection, would also be a part of this fund and the combined amount will be used for investment and the profits earned would again be deposited into the same fund. The company on the basis of set rules and regulations would pay the loss of participants of the fund from this same fund as per its rules. Besides this, all operational expenses that would be incurred for providing takaful services e.g. arrangements of retakaful and building up of reserves will also be met from the same fund.

The sources of income here would be the same as under the Wakalah model covered above. The only difference here mainly relates to the separate Waqf entity being created which resolves a number of Sharia’h related issues and make it a acceptable model for the local Sharia’h scholars at Darool Uloom, Karachi; an institution with a high level of credibility amongst the general public and a reputation.51

From the above it can be concluded that a Waqf model or a combination of Wakalah and Waqf is the best basis for evolving a practical takaful system in India as it is in line with the Shariah principles. Even prior to that, some jurists advocated the use of a Waqf mechanism to develop a Shariah compliant insurance system. Therefore the Waqf model of takaful will be the best in India as it will fulfill all the norms of Shariah and will be acceptable to the people at large.

The researcher has try to analyze the differences between the operational working of different Islamic Insurance Models and their strengths and constraints which are given below in the tabular form.

---

51. Tobias, Frenz, Madhu, Sridharan and Iyer Krishna, Supra note 34
<table>
<thead>
<tr>
<th>Basis of Comparison</th>
<th>Mudarabah</th>
<th>Wakalah</th>
<th>Combined</th>
<th>Waqf</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of Technical Results</td>
<td>Not Applicable (see “share of surplus” below)</td>
<td>None (fixed Wakalah fee without any consideration to the technical results- certain variants of Wakalah/ Combined model, however, include an incentive)</td>
<td>Agreed profit sharing ratio (at times a fixed fee or a fixed fee with incentive profit)</td>
<td></td>
</tr>
<tr>
<td>Share of investment result</td>
<td>Not Applicable (see “share of surplus” below)</td>
<td>None (at times include an incentive profit)</td>
<td>Agreed profit sharing ratio</td>
<td></td>
</tr>
<tr>
<td>Share of surplus (technical and investment results)</td>
<td>Percentage of surplus</td>
<td>None</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss on investments</td>
<td>None (unless found negligent)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating expenses</td>
<td>Borne solely by shareholders fund; direct expenses may be passed on to the policyholders fund</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment instruments</td>
<td>Acceptable Sharia'h compliant instruments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deficit in the policyholders fund</td>
<td>Al-Qard Al-Hasan provided to policyholders fund</td>
<td>Initial Waqf ceding by shareholders and policyholders contributions</td>
<td>Waqf ceding money must go to another Waqf; balances to be paid in charity or disbursed amongst participants</td>
<td></td>
</tr>
<tr>
<td>Creation of Takaful fund</td>
<td>Policyholders contributions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquidation of policyholders fund</td>
<td>Accrue to policyholders only, except provisions and reserves that have to be paid in charity</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prevalent in countries</td>
<td>Partially in Malaysia, Brunei and Saudi Arabia</td>
<td>Sudan, UAE and United Kingdom</td>
<td>Bahrain, Malaysia and Sudan</td>
<td>Pakistan and South Africa</td>
</tr>
</tbody>
</table>
### Strengths and Constraints of different Models of Islamic Insurance

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Mudarabah</th>
<th>Wakalah</th>
<th>Combined</th>
<th>Wakalah Waqf</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>STRENGTHS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comparatively simple model</td>
<td>✓</td>
<td>✓</td>
<td>×</td>
<td>×</td>
</tr>
<tr>
<td>Enhanced profitability as the operator shares in the surplus</td>
<td>✓</td>
<td>×</td>
<td>×</td>
<td>×</td>
</tr>
<tr>
<td>Excessive risk taking in investments mitigated as no upside exists for the operator</td>
<td>×</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Two sources of revenues—Wakalah from contributions and Mudarabah from investments</td>
<td>×</td>
<td>×</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>The provision of Al-Qard Al-Hasan partially limits excessive risk taking by operators</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Incentive for prudent underwriting</td>
<td>✓</td>
<td>x/✓</td>
<td>x/✓</td>
<td>✓</td>
</tr>
<tr>
<td>Shareholders are permitted to share in the technical results</td>
<td>✓</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Legal framework support is limited and complicated</td>
<td>×</td>
<td>x</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>The operator has incentive to take on excessive risk in investments (partially mitigated through Al-Qard Al-Hasan)</td>
<td>✓</td>
<td>x</td>
<td>✓</td>
<td>x/✓</td>
</tr>
<tr>
<td>Direct financial incentives to improve technical results are limited (indirect benefits are realized through distributions to participants and through increased fund size)</td>
<td>×</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

| **CONSTRAINTS** |           |         |          |              |
| No system of corporate governance that effectively addresses and represents the rights of the participants | ✓         | ✓       | ✓       | ✓            |
| No accounting policy which addresses issues of equitable distribution of surplus over time given varied entry and exit by participants | ✓         | ✓       | ✓       | ✓            |
**Humbly Suggested Model**: The researcher has humbly tried to suggest an Islamic Insurance model may suit to the Indian conditions as based upon Sharia'h principles. The model is given below:

![Model Diagram]

**Figure-5: Model of Working of Islamic Insurance**

**General (non-life) Insurance**

- In the case of General (non-life) insurance the whole contribution (C, without being bi-furcated) goes into a common pool (T) from which the risks are met.
- Claims are met by disinvesting T to the extent of requirement.
- Contributions towards re-insurance (Re-takaful) are paid from T.
- Operator I here too manages the fund either on Wakalah or Mudaraba basis for which it is remunerated in accordance with the respective agreement.
Life Insurance (Family Takaful)

P are the policyholders contributing premium C

C the total contributions are bifurcated into two D & R.

D is the amount contributed (as donation) by each participant towards the pool for the stated eventuality befalling the members.

- All claims are met from this account.
- Policyholders forfeit any claim on this in case they survive till the maturity of the policy.
- Any shortfall in this is met through interest free loan from F, which is recoverable in future.
- Surplus is invested and returns plough-back to the account.
- C is the amount which goes into the investment account of each policyholder. Any return from this account is added to the account of the policyholder.
- T, the total amount (investable funds) comprising D&R to be managed by the insurance operator.
- I, the insurance operator, who for managing the fund (T) will charge a fee. Losses are born by fund E.
- P small portion of D (to the extent of risk ceded) is paid towards Reinsurance.

General Observation

- Cost of managing the operations is met by the operator from the re-determined Wakalah fee which is billed to the fund (T) in case of Wakalah model, whereas in Mudaraba model it is borne by the operator (I) and set off against the Mudaraba profit earned by it. This is the reason why Mudaraba model is not so popular.
Based on the actuarial calculation, operator (l) aims at keeping some surplus amount over and above the expected requirement of claims (D) in the case of life policy and (T) in case of general.

Surplus over and above that expectation is either distributed back to the policyholders or they are rewarded in the form of lower contributions in the future.

Any shortfall in D, in Life or T, in General, is met through interest-free loan from the operator (l) which is recoverable in future years.

Guidelines for working of Islamic Insurance

1. All takaful activities must be in compliance with Shariah, which requires the presence of risk sharing based on the principles of ta'awun and tabarr'u, coincidence of ownership, participation in management by policyholders, avoidance of riba (giving or receiving of interest) and prohibited investments, and inclusion of Mudarbah and Wakalah principles in management practices.

2. Takaful participants must act with utmost sincerity (neaa) and adhere to the purpose and principles of takaful, which are cooperative and characterized by risk sharing and mutual assistance.

3. All takaful dealings must be conducted in good faith and with honesty, transparency, truthfulness, and fairness and all should be consistent with Islamic social and moral goals.

4. All takaful activities must be free of haram (forbidden) elements.

5. All takaful contracts must involve parties who have adequate legal knowledge and who are mentally competent.

6. Takaful policies should be based on mutual consent and should specify a defined time period of policy coverage; the principle of indemnity must prevail.
7. Oversight by a Sharia’h advisory council must be provided because Islamic scholars have a role in defining what can be insured and also in approving the structure of final agreements.

8. Takaful operations must undergo regular Islamic audits.\textsuperscript{52}

The working methodology of takaful system is based upon these guidelines. These guidelines are of prime requirement. These guidelines form the core of the working of takaful system as they are based on the Sharia’h law. The researcher has suggested the model on the basis of Wakalah and Waqf model as it is more suited to the requirement of the country. It is already submitted by the experts of this field that the presence of Waqf fulfills all the criteria of Sharia’h compliant insurance system. Therefore, Waqf model of takaful can be operationalised in India as it will contain all elements of solidarity, mutual co-operation, mutual protection and mutual guarantee i.e. the soul principles of Muslims as per the Holy Quran.

\textsuperscript{52} See www.Islamicfinance.com visited on 2/6/2012.