

## **Some Issues of *Gharar* (Uncertainty) in Insurance**

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### **Abstrak**

*Pelbagai isu telah ditimbulkan mengenai kehadiran gharar dalam kontrak insuran, khususnya berkenaan kesahihan wang pampasan sebagai salah satu objek tukaran serta unsur risiko tulen yang menjadikan kehadiran gharar tersebut di luar kawalan manusia. Kajian ini cuba menganalisa kembali isu-isu tersebut dan cuba mengenalpasti punca perselisihan. Dari sini kajian akan cuba memberikan justifikasi terhadap kehadiran gharar dalam akad insuran iaitu sama ada ianya memberi kesan syar'ī terhadap kontrak tersebut atau ia hanyalah unsur yang boleh diketepikan. Kajian ini membuktikan bahawa kehadiran gharar di dalam kontrak insuran adalah signifikan sebagaimana yang diperkatakan oleh sebahagian besar penulisan dalam bidang ini. Dengan ini menjadikan gharar satu daripada faktor yang menyebabkan kontrak insuran konvensional diharamkan.*

### **Introduction**

In 1972, the Fatwa Committee of Malaysian National Religious Council decreed that the conventional insurance as practiced under the Insurance Act 1963 in Malay-

sia is a *fāsid* practice because it contains the elements of *gharar*, *maysir* and *ribā*.<sup>1</sup> Though *gharar* was stated as one of the reasons for its illegality, no further clarification about its existence was mentioned.

The Kelantan Fatwa Committee when ruling about the same issue also gave the same short reasons.<sup>2</sup> The only further indication of *gharar* are the two references cited by the *fatwās* in both committees', namely *Niẓām al-Ta'mīn* by Dr Muḥammad Bahī and *'Aqd al-Ta'mīn* by Muṣṭafā Aḥmad Zarqā.<sup>3</sup> Both are contemporary Islamic law books on insurance.

Zarqā in his another book maintains that the prohibited *gharar* is the exorbitant ones that are uncertainty that still prevail when we ignore the natural ones that can always be found in any types of contract. This type of uncertainty will make a contract similar to that of gambling which depends on chance per se and has no countervalue that is, will only provide profit for one party and loss to another. He further argues that the element of uncertainty in insurance besiege the insurer only in the sense that he is not certain of the happening of the risk. But these uncertainties are small if not negligible when we consider the management of risk in insurance company that is based on reliable statistics and law of large numbers. As for the insured, he faces absolutely no uncertainty, if we see it from the perspective of the contract's objective that is security from the occurrence of the risk. This security is independent of the happening of the risk and with the commencement of the contract it is automatically achieved.<sup>4</sup>

Considering that both *fatwās* reject the permissibility of insurance, then we may conclude that they have rejected the arguments on the prohibited *gharar* in insurance put forth by Muṣṭafā Aḥmad Zarqā and Muḥammad Bahī.

In the literature of Islamic insurance, there are similar divisions on the subject of *gharar* in the contract of conventional insurance. Most classical jurists objected to the contract on the venue of excessive presence of *gharar* in it. Whereas those who advocate reforms in Islamic banking and finance hold that it is permissible under Islamic law based on the arguments that *gharar* implicated in the contract is only a minor one, which is always present in any kind of business transactions. Even if the *gharar* that accompany commercial insurance seems excessive they are due to externalities of the contract thus becomes irrelevant.

This paper is an attempt to clarify the concept of *gharar* in an insurance contract and see whether its implication upon the contract is fully justified. We will solve this by examining the definitions of *gharar* and try to seek its true existence in the insurance contract by bringing forward some of the arguments given by either the proponents or the ones against it pertaining the existence of *gharar* in insurance. To achieve this, we will first put forward the four known venue of *gharar* in insur-

ance and attempt to evaluate the exact nature and the scale of *gharar* in the contract. In order to understand more about it, we will try to examine the point of conflict between the arguments. From here, we will attempt to reach a conclusion on whether the *gharar* is a factual element of insurance and is intrinsic in it or is it arise due to other externalities of the contract only and becomes irrelevant.

## **Literature Review**

Throughout the history of Islamic law, there has been disagreement among scholars as to whether the insurance contract is prohibited or not. The centre of the arguments is based mainly on two grounds, that is, whether it pertains to the kind of contracts involving *gharar* or if it involves *ribā*. Generally, these views can be summarized into three groups which are; those who view the contract as prohibited; those who view it as permitted; and those who view that some types of the contract are permitted while some are prohibited.<sup>5</sup>

The first group mainly consists of the traditional scholars of Islamic laws though some distinguished contemporary scholars like Zuḥaylī<sup>6</sup> and Musleh-ud-Dīn<sup>7</sup> also hold the same view. The second view arises as early as late 19th and early 20th centuries.<sup>8</sup> Among them are Siddiqi (1985) who argues that the contemporary insurance business is based on a Syariah-valid concept and is distinct from *maysir* and *gharar*. And the involvement of interest in it also is not inherent to its concept.<sup>9</sup> The last view contends that not all insurance contracts can be said to be prohibited. Some of these contracts are permitted especially those which are beneficial to the public at large for instance, mutual and cooperative insurance. Among the advocates are Muḥammad ‘Abduh, Muḥammad Abū Zahrah and Muḥammad Yūsuf Mūsā.<sup>10</sup>

Among works on the permissibility of insurance that examines quiet critically on *gharar* in the insurance contract is by Zaraqā (1994). This work is an extension of his early works on Islamic view on insurance especially his ‘*Aqd al-Ta’mīn*.<sup>11</sup> He maintains that since insurance is a contract that has definitive objective upon its commencement, the contractual parties do not rely upon something that is uncertain and not clear. He introduces the concept of security or safety (*al-amān*) as the counter value for the premium paid by the insured which help lessen the uncertainty in the contract.

Sharf al-Dīn (1991) examines the existence of *gharar* in insurance in each of its form. He concludes that the *gharar* in insurance in general, is excessive, though the extent of *gharar* in different types of insurance is different. On discussing the uncertainty of the outcomes of the contract, he questions the ‘security’ as the

counter value as proposed by Zarqā since it is only a motive of the contract and cannot be a subject matter (*ma'qūd 'alayh*) due to its independency from the contract.<sup>12</sup>

Other works on *gharar* mainly discuss the effect of *gharar* and its extent of effect on contracts in general as in the work of al-Dharīr (1995)<sup>13</sup> and Ahmad Hidayat (2000). Ahmad Hidayat for the effect of *gharar* on insurance contract, mentions that there are different views on the permissibility of insurance as well as different trends of views on *gharar* in the contract over time. He contends that the modernist view tends to be more liberal in the sense that the prohibition of *gharar* is qualified according to current circumstances and conditions than the traditionalist view, which is a distillation of the classical jurisprudence on the subject.<sup>14</sup>

Other works that bring out new forms of discussion on *gharar* in insurance are of Rosly (1996), Siddiqi (2000) and Ma'sum Billah (2001). Siddiqi (2000) for the matter maintains that the uncertainty involved in the contract tends to disappear when large numbers are involved.<sup>15</sup> Ma'sum Billah (2001) points out that the possibility of *gharar* being involved in the subject matter of the contract is only through the 'happening of the risk' and this uncertainty is forever will be known by Allah only. The uncertainty comes in the form of pure risk which is implicated with fear of risk, for example the death of the policy holder or the incident insured is not vague and is identified before the commencement of a policy.<sup>16</sup>

Rosly (1996) in the meantime questioned the address of the *gharar* pinpointed by the *fatwa* from the perspective of risks which are dealt by a commercial insurance contract. He suspected that the issue of *gharar* contended by the *fatwa* is misplaced in certain parts that is in the uncertainty of the event, for example the occurring of death or injury. These uncertainties are pure risks that are transferred to the insurer companies by the insured through the payments of premiums and are beyond human control.<sup>17</sup>

Looking back at the literature, we notice that the permissibility of insurance from *gharar* perspective depends on the extent of its existence in the contract. On the other hand, the scale of its existence depends on the accepted subject matter as well as consideration of pure risk as an internal or external factor of the contract. Thus, by trying to determine the precise subject matter as well as resolving the issue of pure risk, the paper may give a new light on the true extent of *gharar* existence in an insurance contract.

### ***Gharar***

The word *gharar* comes from the root verb *gharara* signifying to reveal oneself and

one's property to destruction without being aware of it. Generally it means danger, peril, jeopardy, hazard or risk.<sup>18</sup>

*Gharar* is the uncertainty or indeterminacy involved in transactions where the quality and the quantity of the commodity on sale is not predetermined and known. Similarly, *gharar* is involved when all sales or exchanges of services where the rights and obligations of each party are not known and certain.<sup>19</sup> *Gharar* is also evident when one party acquired profit while the other party did not.<sup>20</sup>

Looking at the *Qur'ān* and *aḥādīth*, there is no direct definition of *gharar* but references of *gharar* in them are plentiful from the examples of contract of sales that are prohibited because of the elements of *gharar* in it.<sup>21</sup> Based on these examples, the classical jurists gave different definitions of *gharar*. Generally, they agree that *gharar* brings out the suspicions of danger because of the uncertainty of outcomes of the contract. But they start to differ when they try to judge the scale and magnitude of *gharar* in each contract and the differences itself arises due to each perception on the reasons behind the existence of the *gharar*. Basically, the reason or cause of *gharar* can either be asymmetrical or lack of information (*jahālah*), or (which is broader in scope) *jahālah* and lack of control.<sup>22</sup> Lack of information which includes ignorance is of the nature and attributes of an object; doubt over its availability and existence; doubt over its quantity; lack of information concerning the price and terms of payment or prospect of delivery. Whereas lack of control is over the risk that may affect one or more parties that may result in loss of property, for example default risk of non-delivery.

Some contemporary scholars have also outlined definition of *gharar*. Muṣṭafā al-Zarqā (1959) for example, maintains that *gharar* is the state of probable items whose existence (which depends on the essential part of the contract) or characteristics are not certain, due to their risky nature.<sup>23</sup>

Wahbah Zuhaylī also maintains that *gharar* is danger whose existence is uncertain whether in its existence, quantity or deliverance which are due to wants of knowledge and lack of control over the time and place of delivery.<sup>24</sup>

The meaning of *gharar* according to the above modern jurists is similar to that of the classical jurists except that they attempt to give more contemporary definitions where the concept of risk is introduced. The most direct reference of *gharar* as risk is adapted by El-Gamal where he inferred *bay' al-gharar* as trading at risk.<sup>25</sup>

There is several indications of *gharar* given by Western scholars which are presented directly or indirectly through their historical and social perspective of *gharar* or its legal sources (Islamic law).<sup>26</sup>

Coulson (1964) for example, maintains that the prohibition of *gharar* is inter-related to the prohibition of *maysir* and *ribā*. He contended that due to the stringent and meticulous adherence of schools of law to the Quranic norms at one point in the development of Islamic law, *ribā* also covers *gharar* or uncertainty that happens when an element of risk between the parties is built into the contract at its inception and as a consequence will result in a profit for one party (i.e. *ribā*) and corresponding loss for the other (i.e. *maysir*).<sup>27</sup>

### Types of *Gharar*

Namely there are two types of *gharar*, that are mostly referred to by scholars when classifying whether a contract becomes invalid or not due to the *gharar* in it, namely, *gharar fāḥish* (excessive *gharar*) and *gharar yasīr* (trivial or minor *gharar*). *Gharar fāḥish*, which means excessive risk is the one that can affect a contract, that is, nullifies it. Examples of *gharar fāḥish* in contracts are plenty as shown by the *ahādīth* and normally is associated with the reasons why *gharar* sales are prohibited.<sup>28</sup> The other kind of *gharar*, i.e. *gharar yasīr*, which means small in amount or trivial is the uncertainty that is always present in all contracts and conducts, thus its existence is tolerated. All scholars agree that every transaction have some amount of *gharar* in it but they start to differ when referring to the amount of *gharar* contained in each.

Some Muslim jurists such as al-Bājī, tries to set a measure to determine whether the *gharar* is *fāḥish* or *yasīr*. For him, if the *gharar* overwhelms the contract until the contract becomes known through it only (that is, there would be no contract of the kind without the *gharar*) than the *gharar* is an exorbitant one.<sup>29</sup>

Other scholars approach it from the *gharar yasīr* or tolerable risk perspective. For them, three conditions need to be fulfilled to identify the risk as tolerable ones. The risk should be negligible, in the sense that the probability of loss is small and its magnitude is limited. It also needs to be inevitable that is out of one's control and lastly, it should not be intentional.<sup>30</sup>

Looking from a different perspective of behaviour, there are two types of *gharar* or uncertainty in any contract. Firstly is uncertainty that happens naturally and the other is uncertainty that happens through deliberate act of parties involved in the contract. The former one which is a natural uncertainty is the uncertainty that will always preside in any contract. For example, the possibility of earning profits from the transaction or loss due to lack of market for the seller is associated with market risk that remains outside the contract. Since this form of uncertainty is naturally embedded before a contract of sale and cannot be eliminated, it is thus negligible in affecting the contract. In this sense, it is similar to the *gharar yasīr*. This

form of uncertainty can also be regarded as a non-*zulm gharar* since it constitutes the risk one must take to justify *Syari'ah* legitimacy.

The second type of *gharar* is the uncertainty arising from *zulm* actions since it is an uncertainty deliberated by one of the parties of the contract such as putting forth vague or uncertain terms.<sup>31</sup> In this manner, many forms of *gharar* will emerge arising from *al-taghrir al-fi'li* (fraudulent acts), *al-taghrir al-qawli* (fraudulent statements) or *al-taghrir bi al-kitman* (fraud by concealment). In each of these activities, one of the contracting party or a third party will deceive the other party, thus inducing him to enter the contract. The deceived party is normally ignorant of the fraud and has no other means of knowing it.<sup>32</sup>

For example, in the case of *taşriyah*, the milk owner purposely tied up the udders of the livestock for few days so as to give the impression to the other party that the livestock have productive milk-yield thereby inducing him to buy them.

Besides these attempts to classify *gharar*, Afzal ur-Rahman<sup>33</sup> differentiates the kinds of *gharar fāhish* into two groups;

1. The elements of peril or risk involving doubt, probability and uncertainty are dominant. For example the sale of fish in the water, sale of birds in the air, sale of a fetus in a womb or sale of a catch by a game-catcher.
2. The elements of doubt are due to the deceit or fraud on the parts of one of the parties. For examples *taşriyah* and *najsh*.<sup>34</sup>

From here, we may conclude that *gharar* due to deliberate act of deceit or fraud by one of the parties is tantamount to *gharar fāhish* but *gharar fāhish* does not exclusively arise from these sources only. Sometimes *gharar fāhish* does arise from within the contract itself even without the party's intention, for instance from the object itself, with a condition that the doubt and uncertainty is dominant. But again, if we say that the parties involved have the ability to choose, then this first group of Afzal ur-Rahman's *gharar* classification still has the elements of deliberateness since he chooses to buy and sell in an environment of which *gharar* is evident.

### **The Effects of *Gharar* on Sales Contract**

Contract of sales entail transfer of ownership of a property in *rem* or *corpus* ('*ayn*) for a consideration (price or *thaman*). Both elements of *corpus* and consideration are known in Islamic law as the subject matter of a contract or *al-ma'qūd 'alayh*. Since contract of sales must observe two essential requirements, namely; 1) the consent of the parties through the formula of *şighah* and 2) the contract must be for

a lawful aim, special conditions were devised by the jurists on the subject matter.<sup>35</sup> Generally in contract of sale, the subject matter must fulfill the following conditions;<sup>36</sup>

1. Reasonable knowledge (*ma'lūm*) in its specification (*ta'yīn*), character (*ṣifah*), and quantum (*qadr*),
2. Able to be delivered or received (*qudrah 'alā al-taslīm* or *tasallum*), and
3. Rightfully owned by the offeror.

If the contract is attached with a condition (*syart*), its term must also be made clear and thus the above requirements are also applicable to the *syart*.<sup>37</sup> For example the sale contract with a condition (*syart*) that a security must be given for the price whether as a pledge (*rahn*) or appointment of a guarantor (*kafil*) is considered valid as long as the kind and value of the pledge is stated in the condition and the appointment must be made with the presence and consent of the said guarantor.<sup>38</sup>

Since *gharar* is the uncertainty that concerns the completion or result of a contract, there is a strong relation between *gharar* and these three conditions. That is *gharar* must not exist in the subject matter. When these conditions are not properly observed, it implies that the element of *gharar* is evident, thus making the contract void.

To the extent of how far is the effect of *gharar*, al-Dharir (1995) lists four necessary conditions for *gharar* to invalidate a contract, which are;<sup>39</sup>

1. It must be major and the determinant of whether the *gharar* is considered major or minor is relativistic,
2. The potentially affected contract must be a commutative financial contract,
3. The *gharar* must affect the principal component of the contract (for instance, price, object of sale, language of the contract ect.),
4. There is no need met by the contract containing *gharar* which cannot be met otherwise. If there is another kind of contract that can achieve the same objectives and contains no *gharar* then the contract that contains *gharar* is no longer permitted based on need (*hājah*).

These conditions, especially the first and the fourth ones imply that the prohibition on *gharar* is not absolute, but instead is restricted by the countervailing consideration of removal of hardship (*raf' al-ḥaraj*) or generally considerations of public interest (*maṣlahah 'āmmah*).

Ibn Taymiyyah on this matter said that since the evil of *gharar* is less than *ribā*, there is a compromise or concession (*rukhsah*) in the form of need (*ḥaraj*) to lift the barrier of *gharar* on certain contracts, but with the stipulation that the evil



caused by the prohibition on *gharar* is more than the evil of *gharar* itself. Imām al Nawawī and al-Kāsānī also have the same stand.<sup>40</sup> Al-Kāsānī gives an example of *khiyār al-syarṭ* (options of condition). He maintains that this option is principally prohibited because it contains *gharar* and that it is against the objective of the contract (*muqtadā ‘alayh*). But it is permitted in the text of law. The reason for the permission of such a condition is considering the necessity to remove *al-ghabn* (the decrease or imbalance of the price offered compared to the actual price) through consideration and observations.<sup>41</sup>

### **Insurance and Its Nature**

Insurance in its legal form may be defined as a buying and selling contract whereby one party, called the insurer undertakes, in return for the agreed consideration, called the premium, to pay to another person, called the assured or insured, a sum of money or its equivalent (the compensation), on the happening of a specified event.<sup>42</sup> It is a contract whereby the insurer assumes the risk of an uncertain event (the insured event or the peril insured against) promising to pay to the insured money or money's worth on the occurrence of such an event.<sup>43</sup>

There are two types of insurance according to the nature of insurance itself. Firstly are contracts of insurance that merely secure the payment of money on the happening of the specified event. In this class of insurance, the amount recoverable is not measured by the extent of the insured's loss, but is payable whenever the specified event happens, irrespective of whether the assured, in fact, sustains a pecuniary loss or not. Life insurance, personal accident insurance and sickness insurance are of this type. Whereas in the other class of insurance, the amount recoverable is measured by the extent of the insured's pecuniary loss. These are contracts of indemnity and normally are known as general insurance policies.<sup>44</sup>

The subject matter of the contract of insurance is money or financial interest protected against the loss to the thing insured. The protection given by the contract of insurance is not a protection against accident in that the contract can prevent an accident from happening. It merely secures for the assured, when the accident happens, the payment of the sum of money. Whereas the subject matter of insurance is different from the subject matter of the contract of insurance in the sense that it exists independently of the contract. It is the thing that the insured fears a risk. For example, in a motor policy, the motorcar is the subject matter, while in life policy, the life of the insured, which is at risk of injury or death is the subject matter. This is also termed as the insurable interest or insurable risk. It is the material interest protected against the unexpected loss or damage.<sup>45</sup>

A contract of insurance also must be entered into for a specific but uncertain occurrence of an event. It is not enforceable should either party be found to be in breach of the principles of *uberimae fidei* (utmost good faith). Benefits from a policy cannot be obtained unless the beneficiary has an insurable interest in the subject matter of the policy.<sup>46</sup>

Uncertain occurrence relates to the insured event's occurrence whether it will or will not happen as well as the time of its occurrence. In life insurance where death is a certainty, the uncertainty relates to the time when it will happen. Insurance on the matter does not decrease the uncertainty for the individual as to whether or not the event will occur, nor does it alter the probability of occurrence, but it does reduce the probability of financial loss connected to the event.<sup>47</sup>

The main function of insurance is to reduce risk. For the insurer, by combining many individual loss exposures, he can reduce it through spreading the cost of the unexpected losses between the participants. The key to this function is the law of large numbers, which implies that increasing the number of loss exposures decreases the risk with regard to the total outcome. As for the insured, he can reduce risk by transferring the risk to the insurer who promises to reimburse him when a loss occurs.

Though there are many types of risk prevalent in the society, an insurance contract only deals with pure risk, which refers to those situations that can result only in a loss or in no change at all (neutral). The exposure to the loss of one's home by fire is an example of an exposure to pure risk. The house either burns or it does not burn. For a life policy, the risk involved is the occurrence of death or injury upon the insured. Both either happen or not. It is the opposite of speculative risk, which refers to the situation that can result in gain, loss, or no change.<sup>48</sup>

However, for practical purposes, not all pure risks can be privately insured. There are ideally certain requirements of an insurable risk like a sufficiently large number of homogenous exposure units to make the losses reasonably predictable. While the loss produced by the risk must be definite or determinable, also must be fortuitous or accidental and unintentional and should not be catastrophic.<sup>49</sup>

### **Issues of *Gharar* in Insurance**

As we know, *gharar* emerges from two sources, either from doubts or deceit. Generally the doubt or indeterminacy about the contract arises when one or both parties enter the contract without knowing exactly what the outcome will be. Neither the insurer nor the insured know the precise nature and extent of their rights and obligations until after the occurrence of the insured event. The second type of *gharar* is

also said to occur in insurance as in most cases the insured when entering into such contracts are unsure, if not totally ignorant of their terms. Most do not read the policy while among those who read it, many do not understand its contents.<sup>50</sup>

Normally the discussion on *gharar* in insurance is focused on the *gharar* due to doubts only. This may be so because the elements of fraud in insurance are controlled by relevant legal acts such as Malaysian Insurance Act 1963.

*Gharar* in insurance arising from doubts is said to take place in four ways, namely; in the contract and compensation's existence; in the contract's outcome; in the length of the contract period and in the amount of compensation and premium.<sup>51</sup>

1. Uncertainty in the existence of the contract especially ambiguity concerning the existence of compensation,

According to the traditional jurists, the subject matter of a sale contract must be of reasonable knowledge (*ma'lūm*) in its specification (*ta'yīn*), character (*ṣifah*) and quantum (*qadr*). It should also be able to be delivered or received, and rightfully owned by the offeror.<sup>52</sup>

The above *gharar* is associated with the deliverability of the subject matter which may arise when the seller has no physical control or inability to deliver or perform the object of the contract. This type of *gharar* happens in contract of *ma'dūm* during the inception of the contract when its existence is not known (*majhūl*) and there is a possibility of non-existence in the future.<sup>53</sup>

Insurance is said to contain *gharar* that is uncertainty in its existence since one of its subject matter (*ma'qūd 'alayh*) namely, the compensation has the possibility of non-existence in the future. The compensation is uncertain because it depends on the occurrence of the insurable risk which may or may not happen. Take for example a case of motor insurance. The coverage normally is annually. During the inception of the contract, there is always uncertainty or ambiguity about the possibility of the occurrence of the insurable risk among which is an accident to the car or the car is stolen during the whole year insured. Because compensation is paid based on proof of loss that is the happening of the insured event, then it relies upon the occurrence of the event. That is the compensation will only be given when the car involved in an accident or was stolen. Since the insured event carries the possibility of 'not-happening' in the time of the contract, then the compensation also carries the possibility of non-existence. And with the possibility of non-existence of the compensation which is one of the *ma'qūd 'alayh* (subject matter), then there arise uncertainty in the existence of the contract itself.

Not all types of insurance carry this type of *gharar*. For example, in permanent or whole life insurance policy where the policy remains in force during entire life-

time,<sup>54</sup> the insurable risk is a certain matter which is death. And with the certainty of death, the indemnity is also a sure thing.<sup>55</sup>

2. Uncertainty in the outcome or result of the contract especially ambiguity concerning the payment of compensation,

This uncertainty arises as a result of the uncertainty in the existence of the contract or specifically the compensation. It happens because there is a possibility of non-occurrence of the insured event during the contract period. With this possibility comes the possibility of non-existence or non-delivery of the compensation. Thus there is no certainty in the payment of the compensation at the initiation of the contract.

For example fire insurance for homes. Because the insurable risk that is fire has the possibility of non-occurrence in the period of contract, the compensation for loss or damage due to it also has the possibility of non-delivery. Since compensation is one of the subject matter, it is required by the Islamic law of contract that it should be able to be delivered. The possibility of non-delivery as mentioned above implies that there is *gharar* in the contract.

Due to this interrelatedness with the uncertainty of the contract's existence, this type of *gharar* exists only in non-permanent types of insurance. For permanent insurance like whole life insurance, the existence or payment of the compensation is a certainty since death is a sure thing and will definitely happen.

3. Uncertainty in the exact amount of the compensation that shall be received by the insured or the amount of premiums by the insurer,

As mentioned above, one of the conditions that must be observed by the subject matter is reasonable knowledge in its quantum (*qadr*).<sup>56</sup> In insurance contract, this condition is applicable to both, the premiums and the compensation.

The uncertainty besieges the premiums for all cases of insurance except some general ones that need to be paid lump sum at the start of the contract, for instance, motor insurance. The uncertainty about the amount of the premium exists because the total amount of the premiums has to be paid by the insured depends on the occurrence of the risk.

If we say that the premiums for all types of insurance are already quoted and listed beforehand according to relevant criteria and the insured already knows the amount he needs to pay monthly in the course of the contract, we might argue that he is in fact not sure how many quoted premiums would he pay in the future. This is again due to his unawareness of the time when the insurable risk will happen.

For example, an insured has to pay installments of RM300 monthly for his life policy. It is true that this amount has already been fixed at the inception of the contract. But the quantum under question is not the monthly payment but the total of all RM300 the insured has to pay in order to receive the compensation. At the inception of the contract, the insured does not have any knowledge of how many RM300 installments shall he pay up till the occurrence of the risk since the other subject matter will only be realized then. The same goes for the insurer as he does not know how many installments shall he receive till the insured event occurred.

If reasons of mutual consent over the premiums where the insured gives his consent to the effectiveness of the contract with the knowledge that he will not know for sure the exact amount of the premiums he will pay in the future, the contract will still be void. This is so because mutual consent regarding the exchange and uncertainty in the subject matter are two distinct conditions of contracts of sale. Mutual consent alone cannot make a contract legal and binding if there is element of uncertainty in the subject matter.<sup>57</sup>

As to the uncertainty concerning the compensation, we should view it from several angles. Firstly is from the uncertainty in the amount of the compensation paid by the insurer and shall be received by the insured. Admittedly there are cases of insurance where the amount of compensation is fixed like in some health insurance, thus there seems to be no uncertainty about the amount of compensation shall be received in the event of the insurable risk.<sup>58</sup> But setting fixed compensation for example for specific injury still carry uncertainty since the injury's existence as well as its extent is not known at the start of the contract.

Another issue is when the compensation is not definite or set in certain ranges at all but is paid based on the insurer's observation about the extent of injury or peril itself like the compensation for burnt house or damaged car. Thus again, the compensation is ambiguous since it depends on the extent of the injury that is not known at the start of the contract.

The uncertainty here not only concerns the exact amount shall be received in the event of the risk but also the formula or 'how' the insurer set the amount of compensation. This uncertainty regarding the formula used also pervades the fixed compensation since the insureds are not really informed in both situations about it. What is prevalent is that the insured only expect that the insurer will somehow pay them the compensation and normally the amount of the compensation is left to be decided solely by the insurers.

4. Uncertainty in the contract period since it is based on a time frame which is not known and cannot be known.

This type of uncertainty exists in all type of insurance contract due to the fact that the knowledge of the happening or occurrence of the insurable risk is beyond anyone's capability and mean. If we say that contracts like motor insurance has its own time frame which normally are annually, the uncertainty is still there. This is so because the insurable risk might happen anytime before the year ends. The same goes to whole life insurance as no one really knows the time of the incident.

If we refer to the uncertainties raised in the insurance contract above, we may notice that all the uncertainties develop because of the element of uncertainty concerning the happening of the event that is pure risk. Only for the compensation, it not only depends on pure risk but also on the insurer's decision that is on the exact amount of compensation paid to the beneficiaries.

All of the argument about the existence of *gharar* in the insurance contract be it major or minor, basically concerns about this root of uncertainties which in conventional insurance is known as pure risk.

Basically, most Islamic scholars admits that uncertainties exist in the contract in the forms as mentioned but they differ about the extent of these uncertainties. The proponent of major *gharar* in insurance see the contract is overwhelmed with *gharar* based on that *gharar* pervades the subject matter through doubts in both price (premium) and *manfaat* (compensation), thus making the contract void.<sup>59</sup> Whereas the proponents of minor or non-*gharar* in insurance view it from a wider perspective where they notice that the *gharar* depends on something beyond human control which is pure risk that cannot be eliminated.<sup>60</sup>

A possible argument for the second view is that the prohibited *gharar* phenomenon only happens in speculative actions that carry not only the possibility of profit or loss but also choice. In this type of action, we also see that elements of *zulm* will prevail when *gharar* is exploited or used by the contracting parties. But then, both parties are free to avoid the uncertainty or make it disappear altogether. Take the sale of fish in a pond as an example. When the contract is initiated as it is, it carries the possibility of getting the fish (i.e. making profit) and not getting it (i.e. making loss). The seller has the choice to avoid the *gharar* by catching the fish first before selling it, thus making the contract legal. Here we see a type of *zulm* emerging from this uncertainty where the seller took the advantage of exploiting the greater *gharar* over a minor *gharar* when he sells the fish he already caught.

The actions that depend on pure risk differ here in the sense that there is no such elements of *zulm* since both sides have no control whatsoever over the risk.

Both parties in contract of insurance face the same kind and level of uncertainty.

If this argument is true, then the only venue for uncertainty is the amount of the compensation as well as its actual payment that is highly dependent on the insurer's decision in awarding compensation.

In making our own conclusion, we decided to investigate the issue of dependency of the subject matter on the uncertainty of time as well as the uncertainty of event. In other words of sales that have *syarṭ* (condition) related to time and event in the future. This is due to the fact that either the premium or the compensation's total amount as well as the existence of the compensations and contract depend on the occurrence of the insurable risk or event and the time its happened.

Taking this into consideration, we noted several views from the classical jurists about contracts of sale on the matter. If a sale contract comes with a time condition or *syarṭ ajal* which is a condition that stipulates that the completion of a contract is to be made at some time in the future, it must be made in specific terms to make the contract valid. And if a contract is attached with a condition which stipulates that its completion shall be made dependent upon some future event, for example upon the arrival of a certain person, this condition is not permitted for the reason of want of knowledge on the completion of the contract. The justification of the requirement is that the exchange of the subject matters for a sale contract must take immediate effect. Any condition that might affect this immediate effect including a condition upon the happening of some unknown future events is not permitted.<sup>61</sup>

So then, it shows that *gharar* in insurance contract though it is due to an external factor which is the pure risk still is considered as intrinsic to the contract thus will affect its legitimacy.

On the other hand, all the above discussions on *gharar* will only be valid if we accept that the subject matters of the contract are the premium versus the compensation. If we accept the view of Zarqā then it would be something else.

He maintains that *gharar* only besieges the insurer and not the insured, thus it is negligible. The elements of chance for the insurer only exist in not knowing whether to pay the compensation or not. And this is only true when the contract is evaluated individually whereas if we consider the pool of contracts managed by the insurance company then the chance becomes a sure thing because it is based on certain statistical measure. Even if the contract is assessed individually, the lack of knowledge about the definite premiums amount that should be received by the insurer will still not rendered the *gharar* to be excessive. The Ḥanafites for the matter differentiate the effect of *gharar* due to lack of knowledge that may prevent the effectiveness of a contract and that may not. And al-Zarqā maintains that since the

periodic premium amount that should be paid by the insured is already known at the time of contract, then the actual premiums amount would not cause a problem if the insurer already promised a specific amount of compensation for each total premium amount paid.<sup>62</sup>

As for the insured, there is no *gharar* at all because the subject matter of any insurance is the transfer of the insurable risk or the uplifting of the possible burden of financial risk (which can bring ease or *al-amān*) and it does not depend on the happening of the risk. The transfer is executed at the beginning of the contract and is not affected by the event itself.<sup>63</sup>

Scholars who are against this view question the competence of *al-amān* to be the subject matter of insurance. They argue that *al-amān* is actually the reason behind insurance not the subject matter.<sup>64</sup> The subject matter is still the financial interest or money (compensation) because this is the ultimate consideration that will be exchanged.

The problem here arises due to different perception of what is the actual subject matter of insurance. If we are talking about the contract of insurance then the subject matter is the financial interest and if it is about insurance, then the subject matter is the insurable risk. And considering the issue is on the existence of *gharar* that would have an impact on the contract itself, we think that the relevant subject matter should be the financial interest.

Furthermore if we consider insurance as a buying and selling contract, Zarqā's argument is not quiet appropriate. In a normal buying and selling contract the transfer of ownership is permanent (where one party will take over the full ownership of the subject matter from the other) for exchange of commodity or money and commodity or even money for money and this is not true for services. For exchange of services and money it is more a contract of hire and as insurance is considered by Zarqā. This is reflected by his analogical example of contract of providing security (*'aqd al-isti'jār 'alā al-ḥirāsah*). As of insurance, the transfer of the compensation is in fact for permanent. This is perhaps the reason why it is considered as a buying and selling contract on the place. And act of hiring the insurance company to cover your financial loss without any permanent transfer of ownership from the company is more likely to happen in the case of non-happening of the event only.

## Conclusion

Based on the above observations, we conclude that conventional insurance does carry excessive *gharar*. Firstly is because the subject matters exchanged in the contract are between money and money which is a kind of a buying and selling con-



tract thus making the contract exposed to conditions or requirements of reasonable knowledge in the subject matters' quantum as well as the ability to deliver them. Thus necessitate a definite fixation of the subject matters and this is not true for an insurance contract. Any breach of one of the conditions constitutes an uncertainty in the subject matters either the premium or the compensation. And consequently these uncertainties will lead to the uncertainty of the execution of the contract itself.

Secondly is all of the uncertainties arise due to uncertainty of the happening of the insured event as well as the time of happening. Although the event or the time is beyond man's control, any contract attached with these conditions is not allowed due to want of knowledge. Want of knowledge itself shall result in the existence of *gharar* in the contract.

## End Notes

1. The general insurance however due to its necessity was decreed permissible as long as there is no other alternative. And as for life policies it was asked for review by the Jemaah Menteri Kebangsaan before it was raised to the Majlis Raja-raja for further approval before it is gazetted. It is still under review. The decree for its illegality however can be issued independently by the states' fatwa committee. And it should be noted here that the fatwā by the National Religious Council is not binding in the states because the laws concerning Islamic conducts are held under each states Majlis Agama Islam. See the 5th National Fatwa Committee Meeting, June 15th, 1972; 16th National Fatwa Committee Meeting, February 15th-16th 1979; 17th National Fatwa Committee Meeting May 3rd 1979 and 18th meeting on May 14th 1980. See also Hailani Muji Tahir (1984), "Islam dan Kedudukan Insurans Nyawa" in *Seminar Kewangan Islam*. January 14th-15th 1984, Universiti Kebangsaan Malaysia for further highlights about the issue of gazetting the national fatwa.
2. For discussion about the issue and the fatwā, see Paper no. 37/72 in the agendas and meeting's minutes of the Jemaah Ulama Majlis on September 9th 1972.
3. Most possible, both books are referred to as a benchmark for the views that permitted the insurance contract. See 4th National Fatwa Committee Meeting, 8th-9th September 1971 and 5th meeting on June 15th 1972. We have an access to only one of the books, that is by Zarqā.
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5. Ahmad Hidayat (2000), *Studies in the Islamic Law of Contracts: the Prohibition of Gharar*, KL: International Law Books, pp. 201-3.

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10. Ahmad Hidayat, *op.cit.*
11. Zarqā, Muṣṭafā M. (1962/1381H), *'Aqd al-Ta'mīn (al-Sukrah) wa Mawāqif al-Syarī'ah al-Islāmiyyah minh*, (working paper delivered during Islamic Fiqh Week in Damascus on April 1961).
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17. Rosly, S.A. (1996), 'Islam and Life Insurance,' *The Sun*. March 22nd.
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19. Siddiqi, M.N. (1985), *Insurance in an Islamic Economy*, pp. 40-41.
20. As defined by Ibn Taymiyah, extracted from <http://www.islamiq.com/knowledge-center/takaful>. p. 4.
21. Ahmad Hidayat Buang (2000), pp. 41.
22. Sharf al-Dīn (1981), pp. 138-9.
23. Zarqā, Muṣṭafā (1959), *al-Fiqh al-Islāmī fī Ṭhawbih al-Jadīd*, v. 1, pp. 697-698. Words in bracket has been added by writer.
24. Wahbah al-Zuhaylī (1989), *al-Fiqh al-Islāmī wa Adillatuh*, v. 4, Damsyiq: Dār al-Fikr. pp. 437.
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26. Ahmad Hidayat (2000), pp. 207.

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32. Yusoff (1998), "Defective Contrcats in Islamic Commercial Law: with Special Reference to al-Ghabn, al-Istighlal and al-Gharar," *MCL.IIUM*. pp. 206-229;.
33. Afzal ur-Rahman (1984), *Economic Doctrine of Islam*, v. 4, pp. 134-140; See also Sanusi M. M. (1993), 'Gharar', *International Islamic University of Malaysia Law Journal*, vol. 3, no.2, pp. 88.
34. *Najsh* is a kind of fraud where one would offers a high price for a thing without the intent to buy but merely to induce somebody who really wants to buy it so as he would buy it at least at the high price.
35. Ahmad Hidayat (2000), p. 102.
36. Sharbīnī, al-Khaṭīb (n.d.), *al-Iqnā' fī Halli Alfāz Abī Shujā'*, vol. 2, Singapore: Maktabah wa Maṭba'ah Sulayman Mar'ī, pp. 2-6; Abū Ṣāliḥ Abd al-Samī' (1947), *Jawāhir al-Iklīl Sharḥ Mukhtaṣar li Khalīl ibn Ishāq*, vol. 2, Cairo: Maṭba'ah Mustafā al-Bābī al-Ḥalabī, pp. 1ff.
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38. Al-Kāsānī, Abū Bakr ibn Mas'ūd (1910), *Kitāb Bādā'i' al-Ṣanā'i' fī Tartīb al-Syarā'i'*, vol. 5, Egypt. pp. 171-2.
39. Al-Dharīr (1994), pp. 583-612.
40. *Ibid.*, pp. 602-3.
41. Al-Kāsānī (1910), *Bādā'i'*, vol. 5, p. 174.
42. Ivamy, E.R. Hardy (1993), *General Priciples of Insurance Law*, London: Butterworth, pp. 3; Dorfman, Mark S (1982), *Introduction to Insurance*, New Jersey: Prentice Hall. pp. 5.
43. The insurer is the party who agrees to pay compensation for the losses and the insured is the party who will receive the compensation. The payment that the insurer receives is called a premium and the insurance contract is called a policy.
44. Ivamy (1993), *ibid.*, pp. 7-10.
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52. Sharbīnī, al-Khaṭīb (n.d) vol. 2, pp. 2-6; Abū Ṣāliḥ 'Abd al-Samī' (1947), pp. 1ff.
53. In *bay' al-salam* and *istiṣnā'*, both are permissible though at the initiation of the contract, the subject matter of each is unknown due to their possibility of existence in the future. See Sharf al-Dīn (1981), pp. 142.
54. [www.lifeinsurance.net/about-whole-life-insurance.htm](http://www.lifeinsurance.net/about-whole-life-insurance.htm), (08/02/2002).
55. Sharf al-Dīn (1981), *ibid*.
56. Want of knowledge in quantum could happen in a contract if the quantity of subject matter is not fully specified by either party or both. It is mostly applicable to *ribawī* goods in order to avoid the implication of *ribā*. Since insurance is a financial contract that involves the exchange of money then the condition is also applicable to it. See Ahmad Hidayat (2000), pp. 121-2.
57. Sharf al-Dīn (1981), pp. 165.
58. Islamic law of contracts for this matter specifies that since this is an exchange of money for money (i.e. *ribawī* transaction) then the exact amount of compensation need to be stated at the commencement of the contract.
59. See Sharf al-Dīn (1981), pp. 142-168; Mahmūd (1994), pp 301-302.
60. Zarqā (1994), pp. 51-52; Ma'sum Billah (2001), pp. 105-106; Saiful Azhar (1996), 'Islam and Life Insurance.' *The Sun*, March 22nd.
61. Ahmad Hidayat (2000), pp. 109-12.
62. Zarqā (1994), pp. 53-55.
63. *Ibid*.
64. Zarqā (1994), p. 73, Sharf al-Dīn (1981), pp. 145-147.