

Insurable Interest in *Takaful* and Application in the UK and Australia

Dr Mahfuz Mahfuz*

Insurable interest used to be considered as an essential element of an insurance contract. However, Australian insurance law, has cast doubt on this by no longer making it a requirement of an insurance contract. The *Shariah* strictly requires this element in order to prevent gambling and moral hazard. The English insurance law holds the similar approach. However, there is contradiction in its application between the *Shariah* and English law. Consequently, it is required to discover how this element can be applied in *Takaful* so that both *Shariah* and English law or the Australian law can be complied with. This article also analyses the different scenarios suggested by the Law Commission and recommends how *Takaful* providers should react if the circumstances change.

Introduction

Takaful (Islamic insurance) is one of the most successful Islamic financial products in the world market with unprecedented growth.¹ As a western hub of Islamic finance London has welcomed its application in the English market.² Salaam Halal was the first company who applied this product in the English market in 2008 and successfully sold 10,000 policies in a year.³

Australia is another country that has proven record of successful application of Islamic financial products, with companies such as the MCCA providing Islamic home finance since 1989,⁴ and Islamic Co-operative Finance Australia Ltd providing Islamic finance since 2011.⁵ Since 2007, the National Bank of Australia have been offering an annual \$25,000 scholarship to allow young Australian Muslims to study finance and ultimately work for the bank so that the bank can improve its understanding of Islamic banking succeed in this market.⁶ The State of Victoria is keen to become the Islamic financial hub of Australia.⁷ Since *Takaful* is a lucrative product

* PhD, University of Manchester; Barrister.

¹ Global Islamic Finance Magazine, 'Islamic Finance Spurring Real Growth'

<http://www.globalislamicfinancemagazine.com/index.php?com=news_list&nid=1962> accessed 15 July 2014. For instance, in Malaysia the annual growth rate of *Takaful* assets and net contributions was '27% and 19% respectively from 2003 to 2007'. See, Bank Negara Malaysia, 'Islamic Banking & Takaful' <http://www.bnm.gov.my/index.php?ch=fs_mfs&pg=fs_mfs_bank> accessed 15 July 2014. The global gross for *Takaful* contributions was \$1,988m in 2005 and an estimated \$8.3 billion in 2010. See, Ernst & Young, 'Industry Growth and Preparing for Regulatory Change – The World Takaful Report 2012' (April 2012) 10 <http://takafulafrica.com/public/uploads/The_World_Takaful_Report_2012_%20by_Ernest_Young.pdf> accessed 15 July 2014.

² 'UK international financial services – the future' (May 2009) 45.

<http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/uk_internationalfinancialservices070509.pdf> accessed 15 July 2014. See, Mark Hoban MP, 'Speech by the Financial Secretary to the Treasury, Mark Hoban MP, to the Association of Foreign Bankers', (14 June 2011) HM Treasury Newsroom & speeches <<https://www.gov.uk/government/speeches/speech-by-the-financial-secretary-to-the-treasury-mark-hoban-mp-to-the-association-of-foreign-bankers>> accessed 15 July 2014.

³ Jamie Dunkley, 'Islamic insurance company Salaam Halal closes to new business' The Telegraph (18 November 2009). However, the company stopped selling the product in 2009 since they were in 'solvent run-off'. They raised £60m whilst they hoped to raise £80m. It is interesting to note that the critics pointed their fingers to several reasons for their failure but did not doubt the possibility of success of *Takaful* product in the UK market. See, Sam Barrett, 'Takaful insurance: A future full of potential' (30 August 2011) Postonline.co.uk <<http://www.postonline.co.uk/post/feature/2105374/takaful-insurance-future-potential>> accessed 15 July 2014. See also, Jane Bernstein, 'Opening the Takaful market' (22 May 2012) Post online.co.uk <<http://www.postonline.co.uk/post/feature/2179084/takaful-market>> accessed 15 July 2014.

⁴ See, <http://www.mcca.com.au/about-us/> accessed 1st April 2014

⁵ See, <http://www.icfal.com.au/> accessed 1st April 2014.

⁶ See, <http://www.yourmortgage.com.au/article/demystifying-muslim-mortgages-79042.aspx> accessed 1st April 2014. See also, <http://www.news.com.au/national/nab-to-introduce-introduce-muslim-friendly-loans/story-e6frfkp9-1225734465168> accessed 1st April 2014.

⁷ See, <http://www.invest.vic.gov.au/financial-services> accessed 1st April 2014.

among the Islamic financial products it is argued that Australia will soon experience the application of *Takaful* and there are many reasons why this product should get approval from the APRA.⁸

However, the Islamic insurance policies cannot be applied in these countries unless and until they comply with their company regulations.⁹ It is evident from the successful application of *Takaful* by Salaam Halal that these policies comply with UK insurance company regulations. Ann Newbrun and Sarah Awad commented that the *Takaful* structures should also comply with the Australian Prudential Regulation Authority guidelines.¹⁰ Consequently, there should not be any regulatory obstacles in the application of these innovative financial products.

However, mere compliance with the insurance company regulations does not end the story. There is another part of an insurance policy that is based on the 'contractual' relationship between the parties. It is also required to see whether the contractual parts of *Takaful* comply with the laws of the country where it is applied. Needless to say that the concept of *Takaful* is created solely on the basis of *Shariah* principles. Consequently, if the *Shariah* principles contradict with any laws of the country where it is applied, the application of *Takaful* will be rendered useless as companies that offer the *Takaful* have to comply with the existing laws of the country in question.¹¹ Hence, it is required to analyse whether the *Shariah* principles and the laws of the country in question contradict when considering insurance contracts. The next question is should there be a contradiction, what steps can a *Takaful* providers take to ensure that their *Takaful* complies with both the *Shariah* and the law of the country in question?

This article will consider only the first part of an insurance contract, which is 'insurable interest'. The article is also limited to life policies and will analyse the laws or recommendations made on or before 1st July 2014. The recommendations made by the Law Commission in recent years¹² will be analysed in order to provide a guideline for *Takaful* providers so that they can take the necessary steps should the circumstances of any countries change in the future. However, there are three issues that need to be considered in order to determine how the *Takaful* should be operated in order to comply with English and Australian law:

- 1) Should insurable interest be a requirement for a valid policy?
- 2) How to determine a valid insurable interest?
- 3) When should the insurable interest exist?

Should Insurable Interest be a Requirement for Takaful?

The sources of *Shariah* principles i.e. *Quran* and *Hadith* do not provide any guidance related to insurable interest. The only available statute for *Takaful* in the world, *Takaful* Act 1984 of Malaysia, does not require the existence of insurable interest. The Report Committee of Malaysia, established in 1982 to discuss the enactment of the *Takaful* Act, suggested that the insurable interest should not be a requirement for a family *Takaful* because there is no scope of gambling and moral hazard as the participants will only participate for the benefit

⁸ See, Ann Newbrun and Sarah Awad, 'Takaful: can it be done in Australia?'

<<http://www.mallesons.com/publications/marketAlerts/2009/InsuranceaneReinsuranceUpdate/Pages/Takaful-can-it-be-done-in-Australia.aspx>> accessed 1st April 2014.

⁹ For instance, FSA announced that there is no restriction in the operation of Islamic policies in the UK as long as the companies satisfy the conditions imposed by FSA. See, Michael Ainley and others, 'Islamic Finance in the UK: Regulation and Challenges', (2007) FSA 22 <http://www.fsa.gov.uk/pubs/other/islamic_finance.pdf> accessed 1st November 2011. Ann Newbrun and Sarah Awad commented that the structures of *Takaful* should 'comply with the prudential standards and satisfy APRA's expectations'. See, <<http://www.mallesons.com/publications/marketAlerts/2009/InsuranceaneReinsuranceUpdate/Pages/Takaful-can-it-be-done-in-Australia.aspx>> accessed 1st April 2014.

¹⁰ Ann Newbrun and Sarah Awad, 'Takaful: can it be done in Australia?'

<<http://www.mallesons.com/publications/marketAlerts/2009/InsuranceaneReinsuranceUpdate/Pages/Takaful-can-it-be-done-in-Australia.aspx>> accessed 1st April 2014.

¹¹ See for instance, *Shamil Bank of Bahrain EC v Beximco Pharmaceutical Ltd (No. 1)* [2004] EWCA Civ 19; [2004]1 W.L.R. 1784; [2004]4 All ER 1072.

¹² The Law Commission decided not to do any further work on insurable interest since there was a lack of consensus among consultees around the detail of the proposals. Consequently, their proposals are not suitable for the special parliamentary procedure for uncontroversial Law Commission Bills. See, David Hertzell and Laura Burgoyne, 'The Law Commissions and insurance contract law reform: an update' (2013) 19 JIML 105, 106.

of themselves and their families.¹³ Academics such as Nusaibah Mohd Parid,¹⁴ and Mohd Ma'sum Billah¹⁵ disagree with this view arguing that the possibility of moral hazard still exists in a family *Takaful*. Moreover, the report committee merely anticipated that a policyholder would not do moral hazard where the policy is taken on his family member such as brother. Whereas, it is assumed that a bitter relationship or separation of two brothers' families may increase the risk of moral hazard. Moreover, the Report Committee considered that the *Takaful* would be taken only by family members, whilst it can also be taken by a creditor or an employer in the countries like UK and Australia.

However, the evidence upon which Islamic scholars rely on for the declaration of validity of insurance policies under Islam prove that insurable interest should be a requirement of the insurance contract. Evidence includes the pre-Islamic practice (approved in the post-Islamic era) of merchants forming a fund to help the victims or survivors of natural hazards or disasters during their trading journeys to Syria, Iraq and other countries. On one occasion, Muhammad (PBUH) was engaged in trade in Makkah, a whole trading caravan, apart from a few survivors, was lost in the desert. The managing board, composed of the members of the contributory fund, decided to pay the price of the merchandise, including the value of the camels and horses destroyed, to the survivors and families of those who perished in the disaster out of the common fund. Muhammad (PBUH) also contributed to that fund from his profits.¹⁶ It is clear from this fact that the merchants co-operated with the families of the deceased and also survivors who suffered loss. They did not pay money to the friends of deceased nor any well-wisher. It is also assumed that the merchants would not have paid the deceased's friends or well-wishers due to the fact that their purpose was to help only the families of the deceased who suffered loss due to their death. Consequently, a person cannot get the benefit of a policy if he does not suffer any loss due to the death of the life insured. Hence, it can be argued that insurable interest is a requirement for a valid *Takaful*.

The second evidence that is relied on is a system called '*Aqila*'. Under this policy, all the members of a killer's family or tribe mutually pooled their resources to ransom a member of a family who had committed a murder. This policy used to be practiced in pre-Islamic era,¹⁷ and was applied by Prophet Muhammad (PBUH) as narrated by Abu Hurairah (RA)

Two women from the tribe of Huzail clashed when one of them hit the other with stone, which killed her and also the foetus in the victim's womb. The heirs of the victim brought an action to the court of Holy Prophet (PBUH), who gave a verdict that the compensation for the infanticide is freeing of a male or female slave while the compensation for the killing the woman is the blood money (*diyat*), which to be paid by the '*Aqilah*' of the accused.¹⁸

Here, the compensation was asked to be paid to the family of the deceased not to any of his friends or well-wishers nor any other person who did not suffer any loss due to his death. Consequently, it is submitted that the benefit of the compensation should go to the persons who suffered loss due to the death. Hence, no policy should be allowed where the policyholder is not supposed to suffer any loss due to the death of the life insured i.e. no policy should be valid without insurable interest.

Moreover, a policy that is taken without any insurable interest becomes a gambling instrument, such as Casino machine. In the case of a Casino machine a customer pays money to play a game. The main purpose of the game is to achieve a certain thing. If the person is successful he earns a large amount of money and if he fails the owner of the machine gets the money paid for playing the game. Here the real sufferings of the customer is the entry money and nothing else. In a similar fashion a policyholder who has no interest on the life insured pays premium to start the insurance i.e. the game. If the life insured dies within certain period that was stipulated in the contract of the game, the policyholder earns a large amount of money. If the life insured does not die within

¹³ See, Nik Ramlah Mahmood, 'The Islamic System of Mutual Insurance: the Malaysian Experience' (1991) 6(3) Arab Law Quarterly 280, 293; Nusaibah Mohd Parid, 'Insurable Interest in Takaful Practices: an Analysis', (2009) 3 ISRA Research Paper 1, 5.

¹⁴ Nusaibah Mohd Parid, 'Insurable Interest in Takaful Practices: an Analysis', (2009) 3 ISRA Research Paper 1, 5-6.

¹⁵ Dr. Mohd. Ma'sum Billah, 'Insurable interest: can the modern law be adopted in Takaful operations?' (2000) Arab Law Quarterly 206, 207.

¹⁶ Afzal-ur-Rahman, *Banking and Insurance: Economic Doctrines of Islam*, (Muslim Schools Trust London 1979) Vol. IV, 32.

¹⁷ Before 610 A.C.

¹⁸ Muhammad bin Ismail Al-Mughirah Al-Bukhari, *Sahih Bukhari* (Dr. M Muhsin Khan tr) Vol. 9. Kitab al-Diyat, No. 45, p. 34.

that period the policyholder loses the premiums and the insurer gets those premiums. Whereas, any form of gambling is illegal under *Shariah* principles. As Allah (SWT) said in the *Quran*, “O you who believe! Intoxicants and gambling...are an abomination of Satan’s handiwork. So avoid that in order that you may be successful”.¹⁹ Consequently, any policy taken without insurable interest should be illegal under *Shariah* principles. Moreover, the policy taken without insurable interest increases the risk of moral hazard and this is also prohibited in the *Shariah*.²⁰ Furthermore, the insurable interest works as a means to prevent evil like wagering and moral hazard. This approach in *Shariah* is known as *Sadd al-dhariah*. Consequently, it is submitted that insurable interest should be a requirement for a valid Islamic insurance policy.

Requirement of Insurable Interest in English Law and the Steps to be Taken by a Takaful Operator

The current approach of insurable interest is governed by the Life Assurance Act 1774. The preamble of the Act states that the making of insurance on lives wherein the assured does not have an interest introduces a mischievous kind of gaming. Section 1 of the Act therefore states that any policy taken on lives wherein the assured does not have interest is null and void. A consultation by the Law Commission found that respondents were in favour of keeping this requirement in life policies²¹ since they were “uncomfortable at the thought that people who do not wish them well can take out policies on their lives” and use them as a threat.²² Consequently, insurable interest remains as an important requirement for a life policy under English law and as such the Takaful operators will not have to take any step in order to require insurable interest in a Takaful contract when applying under this law.

The position of Insurable Interest in Australian Law and the Steps to be Taken by a Takaful Operator

Section 18 (2) of Insurance Contracts Act 1984 states that a contract “is not void by reason only that the insured did not have, at the time when the contract was entered into, an interest in the subject-matter of the contract”. This section has made it possible for a person to insure the life of anyone on the street, no matter he knows him or not. As there is no requirement of having an interest at the time of death, he will receive the insured money once the person dies.²³ Accordingly, “the legislature [is] apparently being prepared to accept the risk that this situation will encourage wagering or gaming on the lives of others”.²⁴

Section 18 (2) makes it difficult for a *Takaful* operator to apply *Takaful* in Australia as policyholders can claim to insure the life of a stranger and treat the policy as a gambling instrument. However, the *Takaful* operators still can apply the requirement of insurable interest following the common practice of the market. Australian insurers assess the proposals and determine the risks using the test of insurable interest before entering into a contract.²⁵ Michael O’Brien therefore argued that “insurable interest is alive and well and practiced in Australia, even though many seem to be reluctant to admit it”.²⁶ The *Takaful* operators, however, cannot incorporate any terms in the contract stipulating that the absence of insurable interest would make the policy void since that would go against the rule of the section. Consequently, the *Takaful* operators have to be more careful in accepting a policy than a conventional insurer in order to make sure that the policyholder has sufficient interest on the life insured and the chance of treating the policy as gambling instrument does not exist.

How to Determine a Valid Insurable Interest under Shariah Principles?

¹⁹ *The Holy Quran*, 5: 90.

²⁰ See for instance, Muhammad bin Ismail Al-Mughirah Al-Bukhari, *Sahih Bukhari*, (USC Centre for Muslim-Jewish Engagement tr, < <http://www.usc.edu/org/cmje/religious-texts/hadith/bukhari/034-sbt.php>>) Vol. 3, Book 34, No. 301 accessed 21 October 2013.

²¹ The Law Commission and the Scottish Law Commission, *Insurance Contract Law: Post Contract Duties and Other Issues* (Consultation Paper No 201, Discussion Paper No 152, 2011) para 13.6

²² The Law Commission and the Scottish Law Commission, *Insurance Contract Law: Issues Paper 4 Insurable Interest* (14 January 2008) para 7.40.

²³ Kenneth Sutton, *Insurance Law in Australia* (3rd edn, LBC Information Services, 1999) para 6.34.

²⁴ *ibid* para 6.34.

²⁵ See, Law Commission and Scottish Law Commission, *Insurance Contract Law: Issues Paper 4 Insurable Interest* (14 January 2008) foot note 26 of Part 7.

²⁶ Michael O’Brien, ‘Insurable interest — Social welfare & semantics’ (2006) 17 ILJ 105, 117.

The concept of *Takaful* is derived from the principle of cooperation laid down by the *Shariah* principles.²⁷ The literal meaning of cooperation is “willingness to be helpful and do as one is asked”.²⁸ In an insurance policy cooperation should mean to rescue the victim, i.e. the policyholder from his loss. Consequently, the amount that a policyholder loses is his interest in an insurance policy. Hence, the amount of loss should be determined in order to decide the valid insurable interest. There are two categories of loss that can be identified where the life insured dies, countable loss and uncountable loss.

Countable Loss

In certain relationships the financial loss can be counted. For example, the loss of a creditor can be counted after the death of his debtor. Consequently, the debt amount should be considered as a valid insurable interest. Moreover, under *Shariah* principles a debtor is required to repay his creditor before his death. The repayment of debt is so important that the Prophet Muhammad (PBUH) used to ask the people before performing any funeral prayer whether the deceased had any debt to repay. If the deceased had left any unpaid debt and no wealth to repay them he would not have led the funeral prayer unless there was an assurance of the repayment of that debt by someone else. It was narrated by Salama bin Al-Akwa

Once, while we were sitting in the company of Prophet, a dead man was brought. The Prophet was requested to lead the funeral prayer for the deceased. He said, "Is he in debt?" The people replied in the negative. He said, "Has he left any wealth?" They said, "No." So, he led his funeral prayer. Another dead man was brought and the people said, "O Allah's Apostle! Lead his funeral prayer." The Prophet said, "Is he in debt?" They said, "Yes." He said, "Has he left any wealth?" They said, "Three Dinars." So, he led the prayer. Then a third dead man was brought and the people said (to the Prophet), Please lead his funeral prayer." He said, "Has he left any wealth?" They said, "No." He asked, "Is he in debt?" They said, ("Yes! He has to pay) three Dinars.", He (refused to pray and) said, "Then pray for your (dead) companion." Abu Qatada said, "O Allah's Apostle! Lead his funeral prayer, and I will pay his debt." So, he led the prayer.²⁹

This Hadith clarifies that the family of the deceased or other fellow Muslim may cooperate in the repayment of the debts of the deceased. Consequently, the policyholders of *Takaful* may cooperate in the repayment of the debts of the deceased from their designated risk pool. This means that a policy could be taken out by the debtor on his own life for the debt amount or the creditor on the life of the debtor for that amount.

Uncountable Loss

The uncountable loss can be found within the relationship between spouses, parents and child, where the relationship is based on ‘natural affection’. However, Professor Billah suggested that a valid insurable interest should also be found where the policyholder has moral or spiritual relationship with the life of the insured.³⁰ It is argued that such an extension of insurable interest will create further chance of gambling and moral hazard. For instance, there may be thousands of followers of a spiritual leader. The person who is not a follower can also pretend to be a follower in order to get a policy and it would be nearly impossible for an insurer to establish the genuine nature of his faith. Subsequently, the second person can gamble on the life of that leader or may also become encouraged to do moral hazard. It has already been stated that gambling and moral hazard are prohibited by the *Shariah* principles. Consequently, the approach suggested by Professor Billah is unjustifiable to be applied under *Shariah* principles.

It is, however, accepted that there is a valid insurable interest in the relationship based on natural affection. As evidence the above-mentioned incidences can be referred where Prophet (PBUH) allowed co-operating the deceased’s family members whose relationship was based on natural affection. However, there is a difficulty in calculation of loss in these categories of relationship. Nusaibah Mohd Parid exemplified the issue with the relationship between a father and child. She argued that it would not be acceptable to say that the father had lost the money he has spent on the child since it was his obligation to spend that money.³¹ Consequently, “the money

²⁷ Allah (SWT) said, ‘Help you one another in righteousness and piety.’ *The Holy Quran*, 5:2

²⁸ A S Hornby, *Oxford Advanced Learner’s Dictionary*’ (5th edn, Oxford University Press, 1996) 257.

²⁹ *Sahih Bukhari*, Vol 3, Book 37, Number 488.

³⁰ Dr. Mohd. Ma’sum Billah, ‘Insurable interest: can the modern law be adopted in Takaful operations?’ (2000) *Arab Law Quarterly* 206, 207.

³¹ Nusaibah Mohd Parid, ‘Insurable Interest in Takaful Practices: an Analysis’, (2009) 3 *ISRA Research Paper* 1, 32.

really belongs to the recipient [child in this case] and not the provider [father]”.³² As Allah (SWT) says “do not kill your children because of poverty. We provide for you and for them”.³³ The probable loss of future support by the child to the parents when they would be old is also incalculable since probable future loss is not covered by the *Shariah* principles as it is uncertain.³⁴ Prophet Muhammad (PBUH) “forbade the sale with uncertainty in it”.³⁵ It is narrated from Anas ibn Malik that the Prophet Muhammad (PBUH) forbade the selling of fruit until it had become mellow. He was asked, “Messenger of Allah, what do you mean by become mellow?” He said, “When it becomes rosy”. The Messenger of Allah (PBUH) added, “Allah may prevent the fruit from maturing, so how can you take payment from your brother for it”.³⁶ Similar rulings can be found in the following Hadith

Narrated by Ibn ‘Umar ‘In the pre-Islamic period of ignorance the people used to bargain with the meat of camels on the principles of habal-al-habala which meant the sale of a she-camel that would be born by a she-camel that had not yet been born. The Prophet (PBUH) forbade them such a transaction’.³⁷

Considering these difficulties with policies taken on the life of loved one, it can be assumed that taking a policy on own life or the life of a loved one is illegal under *Shariah* principles. Whereas, Allah (SWA) said in the Quran “Help you one another in righteousness and piety”.³⁸ He also said “And lower your wings for the believers”.³⁹ Prophet Muhammad (PBUH) said “One who strives to help the widows and the poor is like the one who fights in the way of Allah”. The narrator of this Hadith said: I think that He (PBUH) added also: “I shall regard him as the one who stands up (for prayer) without rest and as the one who observes fasts continuously”.⁴⁰

It is evident from these Quranic verses and Hadith that fellow Muslims should support the close relatives of the deceased. If the husband is the only earner of the family and he dies, the family needs financial support. In such circumstances the fellow *Takaful* participants can help through their contributed amount in the pool. However, the question of the amount of interest that can be insured remained elusive. Nusaibah Mohd Parid emphasised on valuing a life,⁴¹ but found no viable solution and left it open for the academics to make further suggestions.⁴² In the author’s view, the valuation of such lives is not possible since the life of a spouse is invaluable to the other or the life of a child is invaluable to his parents. Consequently, a different approach is required. This could be through the provision of financial cooperation to the deceased’s family instead of compensation. Moreover, the concept of *Takaful* is principally based on the question of cooperation.

At this stage the question becomes, how much should the fellow participants of the *Takaful* provide the deceased’s family? If the family’s earnings are low, they must not live in an expensive house or drive an expensive car. On the other hand, a family with high income will have different standards. If the *Takaful* participants provide a large amount of money to the low earning family, it would give them extra benefit for the death of the deceased. This can be categorised as an imbalance and unjust enrichment. On the other hand, if the *Takaful* participants provide a low amount to the latter family that support would mean nothing to them and cannot be considered as adequate cooperation. Consequently, a balance is required. In the author’s view the balance can be created by limiting the amount that a person can insure his/her own life or the life of their spouse for the amount equivalent to his/her past five-year income. The person can insure for a lower amount but they cannot exceed the limit. If the person is dependent on another, he should calculate the earnings of the person on whom they are dependent. If the family has two or more earners and the whole family survives on that total

³² *ibid.*

³³ *The Holy Quran*, 6:151.

³⁴ Nusaibah Mohd Parid, ‘Insurable Interest in Takaful Practices: an Analysis’, (2009) 3 ISRA Research Paper 1, 33.

³⁵ Imam Malik, *Muwatta*, (USC Centre for Muslim-Jewish Engagement tr, <<http://www.usc.edu/org/cmje/religious-texts/hadith/muwatta/031-mmt.php>>) Book 31, Number 31.8.11. Accessed 15 July 2013.

³⁶ *ibid* Book 31, Number 31.8.11.

³⁷ Muhammad bin Ismail Al-Mughirah Al-Bukhari, *Sahih Bukhari* (Dr. M Muhsin Khan tr) Vol 5, Book 58, Number 183.

³⁸ *The Holy Quran*, 5:2.

³⁹ *ibid*, 15:88.

⁴⁰ Al-Imam Abu Zakariya Yahya Riyad-us-Saliheen, Vol 1, No 265 (cited from Sahih Bukhari and Muslim); Muhammad bin Ismail Al-Mughirah Al-Bukhari, *Sahih Bukhari* (Dr. M Muhsin Khan tr) Vol 8, Book 73, no. 35.

⁴¹ Nusaibah Mohd Parid, ‘Insurable Interest in Takaful Practices: an Analysis’, (2009) 3 ISRA Research Paper 1, 29-32.

⁴² *ibid* 35-6.

earning, the limit would be the amount equivalent to their past five-year income. This recommended amount would establish certainty and strike the right balance. This balanced amount would reduce the attraction towards moral hazard, the risk that is higher where the insured is allowed to take a policy for larger amount.

Valid Insurable Interest in English Law

The Life Assurance Act 1774 did not provide any guideline as to how the 'interest' should be determined. Subsequently, the courts divided the insurable interest into two parts considering the relationship between the policyholder and the life insured. In the case of the first relationship, the courts intend to calculate the loss and as such the author considers it as relationship based on countable loss. In the case of the second relationship the courts deem that insurable interest already exists and do not intend to count the interest. Moreover, it is impossible to calculate the loss in such categories of relationship. Consequently, the author categorises it as the relationship based on uncountable loss. Hence, the author divides the category of insurable interest into countable loss and uncountable loss.

Countable Loss

In the case of countable loss the courts find it difficult to decide which categories of loss can be considered as insurable.⁴³ In *Feasey v Sun Life Assurance Co of Canada*,⁴⁴ Waller LJ suggested that the "context and the terms of a policy with which the court is concerned will be all-important" to determine the insurable interest.⁴⁵ In this case, the court provided clear guidelines as to how to determine the existence of valid insurable interest. The court suggested asking four questions to find a valid insurable interest,⁴⁶

- a) "[W]hat, on the true construction of the policy, is the subject matter of the insurance?"
- b) "Is there an insurable interest which is embraced within that subject matter?"
- c) "Is the insurable interest capable of valuation in money terms at the date of the contract?"
- d) Under section 3, "whether the sum payable under the policy is greater than the value of the pecuniary interest valued as of the date of the policy".

The first question deals with the basic issue and as such does not require further analysis. The other three questions, and the second question in particular, require further analysis, as the Act does not define which categories of interest should be insurable. Waller LJ referred to different authorities that recognise a basic condition for a valid insurable interest, which is "the assured's pecuniary interest in the subject-matter of the insurance arising from a relationship which is recognised in law".⁴⁷ "A mere expectancy or hope of future pecuniary benefit from the prolongation of the life insured or of the fulfilment by him of moral obligations owed to the assured, are insufficient to sustain insurable interest".⁴⁸ Consequently, in the absence of a legal obligation on the assured to spend money for the life insured, no pecuniary interest was found between the relationship of parent and child in *Halford v Kymer*⁴⁹ and in *Harse v Pearl Life Assurance Co Ltd*.⁵⁰

The decision of the leading case *Dalby v India and London Life-Assurance Co*⁵¹ should be sufficient for the analysis of the third point. In this case the court held that section 1 of Life Assurance Act 1774 only required the interest to be present at the day of taking policy.⁵² This established the concept that life insurance is an insurance of a sum of money to be paid at the death of the life insured in consideration of the due payment of certain annual premiums paid during the life even if the condition as to advantage, safety or other quality does not continue after creation of the policy or none of them exists at the time of his death.⁵³ The decision in *Hebdon v West*⁵⁴ explains the fourth point. In this case the assured took two policies with two insurance companies for the

⁴³ See for instance, *Feasey v Sun Life Assurance Co of Canada* [2003] EWCA Civ 885 [71] (Waller LJ)

⁴⁴ *ibid.*

⁴⁵ *ibid* [71]

⁴⁶ *ibid* [98] (Waller LJ)

⁴⁷ Nicholas Legh-Jones QC, John Birds and David Owen (eds), *Macgillivray on Insurance Law* (11th edn, Sweet & Maxwell 2008) 9, para 1-13.

⁴⁸ *ibid* 37, para 1-75.

⁴⁹ (1830) 10 B & C 724.

⁵⁰ [1903] 2 KB 92.

⁵¹ (1854) 15 CB 365.

⁵² *Dalby v India and London Life-Assurance Co* (1854) 15 CB 365, 389 (Parke, B).

⁵³ See *Hebdon v West* (1863) 3 B & S 579.

⁵⁴ *ibid.*

amounts of £5,000 and £2,500. Whereas, his interest at the day of taking policies was £3,000. He recovered £5,000 from the first insurance company and failed to recover any money from the second insurer since he had already recovered more than his interest.

Uncountable Loss

In the case of a policy taken on own life, spouse's life or the life of civil partner⁵⁵ the courts state that the parties have deemed insurable interest and they can take policy for any amount with any number of insurers they wish. The reason for this, is that these relationships are based on love and affection, and as such they are outside the mischief of wagering that the 1774 Act was passed to prevent. For example, Farwell LJ said in *Griffiths v Fleming and Others* that "A man does not gamble on his own life to gain a pyrrhic victory by his own death".⁵⁶ Regarding the policy taken on spouse's life, Lord Kenyon held in *Reed v Royal Exchange Assurance Co* that "it must be presumed that every wife had an interest in the life of her husband".⁵⁷ Farwell LJ said in *Griffiths v Fleming and Others* that "a husband is no more likely to indulge in "mischievous gaming" on his wife's life than a wife on her husband's".⁵⁸ It is not a question of property at all; it is that for this purpose husband and wife stand on the same footing".

What Measures should Takaful Operators Take in Order to Apply Takaful under English Law?

In order to find the measures that *Takaful* operators should take, it is required to know the inconsistencies between the *Shariah* principles and the current English insurance law in the following two categories of loss.

Countable Loss

The current English insurance law states that an insured cannot take a policy unless he has legal pecuniary interest on the life that is to be insured. For example, a creditor on the life of a debtor, or an employer on the life of an employee. It has been discussed above that such policies are valid under *Shariah* principles.

Uncountable Loss

As it is stated above, current English insurance law allows spouses and civil partners to take a policy on the other's life for any amount and with any number of insurers they like. Similar approach is taken on the insured's own life.

There are two difficulties in the application of *Takaful* under this part of insurance law. The first one is related to the allowance of taking out a policy for an unlimited amount. It has been discussed above that such unlimited amount of policy will create uncertain benefit for the insured and as identified by Nusaibah Mohd Parid this is illegal under *Shariah* principles.⁵⁹ Moreover, such unlimited amount may create the chance of gambling and moral hazard. For instance, a husband who does not like his wife few years after marriage may gamble by way of taking a policy for a large amount of money on his wife's life, which may also encourage to do moral hazard. Furthermore, providing a large sum of money to a low earning family would give them extra benefit for the death of the loved one. This can be categorised as an imbalance and unjust enrichment. Consequently, the *Takaful* operators have to take special measures by incorporating certain terms in their contract giving the effect to the aforementioned recommendations in order to create a balance and reduce the attraction towards moral hazard.

The second difficulty is related to the policies taken on civil partners. The relationship between civil partners is illegal under *Shariah*. Prohibiting homosexual relationships, Allah (S.W.T.A) said in the Quran, "Indeed, you approach men with desire, instead of women. Rather, you are a transgressing people".⁶⁰ However, under Sex Discrimination Act 1975 the Islamic insurers cannot treat civil partners differently from any married couple. Consequently, a *Takaful* operator cannot refuse to insure any civil partner. In such circumstances they should

⁵⁵ Section 253 of the Civil Partnership Act 2004.

⁵⁶ [1909] 1 KB 805, 808; See, *Wainwright v Bland* 1 Moo. & R. 481.

⁵⁷ Peake, Add. Cas. 70.

⁵⁸ [1909] 1 KB 805. 821.

⁵⁹ Nusaibah Mohd Parid, 'Insurable Interest in Takaful Practices: an Analysis', (2009) 3 ISRA Research Paper 1, 33. See also, Muhammad bin Ismail Al-Mughirah Al-Bukhari, *Sahih Bukhari* (Dr. M Muhsin Khan tr) Vol 5, Book 58, Number 183.

⁶⁰ *The Holy Quran*, 7:81. See also, 26:165-166.

create a separate pool for such kinds of policy, simply to comply with English law, and deal with them separately. If there is any profit from this part of the pool they should donate that profit to the poor since consuming profit from an illegal trade is illegal under *Shariah* principles. The following Hadith can be referred in this regard,

Narrated Jabir bin 'Abdullah: I heard Allah's Apostle, in the year of the Conquest of Mecca, saying, "Allah and His Apostle made illegal the trade of alcohol, dead animals, pigs and idols." The people asked, "O Allah's Apostle! What about the fat of dead animals, for it was used for greasing the boats and the hides; and people use it for lights?" He said, "No, it is illegal." Allah's Apostle further said, "May Allah curse the Jews, for Allah made the fat (of animals) illegal for them, yet they melted the fat and sold it and ate its price."⁶¹

Different Approaches Suggested by the Law Commission

The approaches suggested by the Law Commission are based on two categories of loss, countable and uncountable. Consequently, their proposals should also be analysed under these two headings.

Countable Loss

In their Consultation Paper 201, the Law Commission opined to widen the test for an insurable interest based on economic benefit.⁶² In their view, the current English law requirement is narrow.⁶³ It does not allow insuring the life of a person upon whom the insured is financially dependent. They argued that this narrow approach could lead to many technical distinctions. They gave the example of insurance on key employees and joint debtors in favour of their argument. They argued that the "insurance on key employees is limited to loss during the notice period, plus the costs of replacement". Whereas, it is difficult to decide whether "the insured amount should be confined to a reasonable expectation of the likely benefit or loss. Such valuations are inevitably uncertain and subjective: no-one can know exactly how valuable an employee will be to a firm at the time of death." The second problem they identified is that the "joint debtors may insure the principal of a loan, but not future interest payments".⁶⁴

Considering the difficulties with the current approach the Law Commission proposed that "an insurable interest may be found where the proposer has a real probability of economic loss on the death of the person insured".⁶⁵ They proposed 'a reasonable valuation test' for calculating the loss that can be insured. The valuation should be made at the time of the contract.⁶⁶

Uncountable Loss

The Law Commission proposed three limited extensions to the existing category of natural affection.⁶⁷ The first is children under 18. The Law Commission found that there is a demand in the current market for insurance on children under 18 and there are some products such as family travel insurance, where small amount is paid to parents on the death or injury of a child under 18, are sold in the present market. In order to keep the law in-line with market practice, the Law Commission proposed to allow legal parents and all those who treat a child as a child of the family to insure the life of that child.⁶⁸ However, they did not provide any specific suggestion whether the parents or the persons who treat the child as a child of the family should have unlimited insurable interest or their interests should be limited by a cap.⁶⁹ The second category is the cohabitants who have lived in the same household as spouses for five years.⁷⁰ The third category is the trustees of pension or group schemes.

⁶¹ Muhammad bin Ismail Al-Mughirah Al-Bukhari, *Sahih Bukhari*, (USC Centre for Muslim-Jewish Engagement tr, < <http://www.usc.edu/org/cmje/religious-texts/hadith/bukhari/034-sbt.php>>) Vol. 3, Book 34, No. 438 accessed 21 October 2013.

⁶² The Law Commission and the Scottish Law Commission, *Insurance Contract Law: Post Contract Duties and Other Issues* (Consultation Paper No 201, Discussion Paper No 152, 2011) para 13.27.

⁶³ *ibid*, para 13.29.

⁶⁴ *ibid*.

⁶⁵ *ibid*, para 13.71.

⁶⁶ *ibid*, para 13.73.

⁶⁷ *ibid*, para 13.28.

⁶⁸ *ibid*, para 13.79.

⁶⁹ *ibid*, para 13.86.

⁷⁰ *ibid*, para 13.101.

What Measures should Takaful Operators Take in the Approaches Suggested by the Law Commission?

Alike in the above structure, it is required to find the inconsistencies between the *Shariah* principles and the approaches suggest by the Law Commission in the following two categories of loss.

Countable Loss

The Law Commission proposed that an insurable interest should be found where there is a real probability of benefit on the preservation of the life insured or an economic loss on his death. Following this recommendation, an employer can take a policy for a large amount on a key employee considering the fact that they would suffer a large amount of loss if he dies since it would be hard to replace him. Similarly, a dependant can insure his guardian who sincerely takes care of him. In order to decide whether such a wide category of interest is allowed under *Shariah* principles, it is required to consider whether this would create an opportunity for gambling or moral hazard. The Law Commission gave an example of when it would create such opportunities. They said that, “insuring the life of the tea-man for £3 million seems to be more like gambling than insurance”.⁷¹ Here insurance is taken for more than the real probable loss. On the other hand, a policy of £3 million on the life of a key employee like Steve Jobs from Apple should not be considered as gambling. Hence, it is required to examine the amount before taking a policy. This should be the job of both insured and insurer. It should be the duty of the insured to provide reason why the proposed insured amount is reasonable and the duty of the insurer would be to decide whether the amount is reasonable or not considering the reasons given by the proposed insured. However, the Law Commission do not intend to impose any such duty on the insurer. They considered the views of the respondents of their Issues Paper 4 who said that the insurer would check the amount as a matter of course and the imposition of statutory duty “might contribute to additional costs or duplicate other regulatory requirements”.⁷² It is evident from this statement that it is a common practice by the insurers to examine the validity of the proposed insured amount. It follows that Takaful operators should also examine the amount so as to prevent the chance of gambling or moral hazard.

The aforementioned analysis has clarified that the proposed wide definition of insurable interest by the Law Commission would not create the chance of gambling or moral hazard if the duties proposed by the author is followed by both parties. Moreover, widening the scope of insurance is supported by the *Shariah* principles. As Allah (S.W.T) said “help you one another in righteousness and piety”.⁷³ Where an insured suffers loss due to the death of his guardian or key employee, the fellow *Takaful* operators should provide financial support from the *Takaful* pool. Consequently, the proposed suggestions would not cause any difficulty in the application of Islamic insurance policies.

Uncountable Loss

It is stated above, that the Law Commission proposed three extensions to the existing category of policies based on natural affection. They proposed to include cohabitants, trustees of pension or group schemes and finally children under 18.

The steps that a *Takaful* provider should take in insuring the life of spouse or civil partner or own life have been discussed above. Consequently, the proposed three extensions will be discussed in this part.

The aforementioned two difficulties, in the application of *Takaful* under this category, will also hit in these three extensions. The first difficulty in the application of an unlimited amount will continue to exist in the case of group insurance or pensions schemes where a policy is taken by a trustee in the lives of group members. The Law Commission proposed that the trustee should have unlimited insurable interest in the lives of those group members. This proposal is based on the argument that the “employees are insuring their own lives through the trust by their own contributions or by contributions paid on their behalf by their employer in return for services to that employer”.⁷⁴ It has been analysed above that unlimited interest on any life is not allowed under *Shariah* principles. Consequently, the policy has to be taken under certain value, which the author has proposed as to be

⁷¹ *ibid*, para 13.72.

⁷² *ibid*, para 13. 62.

⁷³ *The Holy Quran*, 5:2.

⁷⁴ The argument is made by Standard Life, quoted by The Law Commission and the Scottish Law Commission, *Insurance Contract Law: Post Contract Duties and Other Issues* (Consultation Paper No 201, Discussion Paper No 152, 2011) para 13.45.

the amount equivalent to past five-year income.⁷⁵ Moreover, such group policies are taken for the benefit of the employee's family. The family whose earnings are low will enjoy a hefty profit if a large amount of policy taken on the employee's life leading to an unjust enrichment as identified above.

The similar difficulty can be found if parents or those who treat the child as their family member are allowed to take a policy for an unlimited amount on their child's life. However, if a cap is imposed then the *Takaful* operators will have to examine whether the capped amount is larger than the past five-year income of the earner or lower. If the cap is lower the *Takaful* operators have to follow the cap since that would be mandatory. If the cap is larger than the five-year income should be considered.

The second difficulty is related to the policies taken by cohabitant. The relationship of cohabitation is illegal under *Shariah*. Allah (S.W.T.A) said "The [unmarried] woman or [unmarried] man found guilty of sexual intercourse - lash each one of them with a hundred lashes, and do not be taken by pity for them in the religion of Allah, if you should believe in Allah and the Last Day. And let a group of the believers witness their punishment".⁷⁶ Consequently, the *Takaful* providers should refuse taking policy on the life of cohabitants. However, if the law of a country treats cohabitants alike married couple then the *Takaful* providers have to follow the guidelines that have been proposed for the policies taken on the life of a civil partner.

Validity of Insurable Interest in Australia and the Steps to be Taken by a Takaful Operator

It has been stated above that the Insurance Contracts Act 1984 does not require the insurable interest for a valid policy. Consequently, the *Takaful* operators are free to decide what amount they should allow to insure considering the interests of the insured. Hence, they can apply the recommendations of the author to make their policy *Shariah* compliant.

When should the Insurable Interest Exist under Shariah Principles

It is an important question in the insurance market when the said 'insurable interest' must exist in the life policy. There are three possible approaches that can be taken: first, the insurable interest must exist only at the time of taking policy; second, the insurable interest must exist only at the time of claim; third, the insurable interest must exist both at the time of taking policy and claim. Each of these approaches is required to be analysed.

Insurable Interest Must Exist at Time of Policy

English insurance law requires that the insurable interest must exist at the time of taking policy. As identified by the Law Commission and academics there are three problems with this approach. The first problem is that the insured gets the opportunity to use the insurance policy as a gambling instrument. For instance, the creditor who has already received the debt amount, against which the policy is taken, may continue the policy in order to have double recovery upon the death of the debtor.⁷⁷ The second problem is that the creditor may get inspired to kill the debtor in order to get the insured amount.⁷⁸ It has been stated above that the *Shariah* prohibits both gambling and moral hazard. Consequently, this approach should not be supported by the *Shariah* principles.

The third problem is identified by Jacob Loshin, who pointed out that the moral hazard by the insurer can be committed if this approach is applied.⁷⁹ This approach invalidates a policy if the policyholder does not have insurable interest at the day of taking policy. Consequently, an insurer gets relief from paying the insured amount once it is discovered that the policyholder did not have insurable interest on that day. Usually the insurers take the advantage of this process by raising the issue of insurable interest once claim is made in order to avoid the payment. If no claim is made, the insurer does not raise the issue and enjoys the benefit of the

⁷⁵ The practicality of this proposal can be confirmed following the example given by the Law Commission that a 'group life policy taken out by an employer on the life of an employee which pays four times the employee's annual salary'. The Law Commission and the Scottish Law Commission, *Insurance Contract Law: Issues Paper 4 Insurable Interest* (14 January 2008) para 3.61

⁷⁶ *The Holy Quran*, 24:2. See also, 17: 32.

⁷⁷ Law Commission and Scottish Law Commission, *Insurance Contract Law: Issues Paper 4 Insurable Interest* (14 January 2008) para 4.15.

⁷⁸ *ibid* para 4.15.

⁷⁹ Jacob Loshin 'Insurance Laws' Hapless Busybody: A Case Against the Insurable Interest Requirement' (2007) *The Yale Law Journal* 474, 485, 487-488.

policy. This “encourages insurers to issue more such policies” which they predict would be invalidated for lack of insurable interest. Further, in many cases it is unclear whether the insurable interest exists or not, and if exists, how much.⁸⁰ This “doctrinal uncertainty permits insurers to maintain the appearance of good faith for policies that are not clearly invalid when issued. Taken together, these dynamics create perverse incentives that work to subsidize moral hazard rather than to discourage it”.⁸¹ For example, in *Patel v Windsor Life Assurance Co Ltd*⁸² the insurer Virgin Direct issued a policy on Mr Barot’s life even after they found an anomaly in the statements made in the application form. They raised these issues once the insured amount was claimed. Such moral hazard is illegal under *Shariah* principles and as such this approach would not be supported by the *Shariah*.

Insurable Interest Must Exist at the Time of Claim

This approach will make the policy an indemnity policy. The insured will be allowed to take a policy for any amount he wants but he can recover only the amount that he suffers loss at the day of claim. For instance, if the aforementioned debtor repays £90,000, out of £100,000, before his death the insured will receive £10,000 from the insurer upon his death. The principal problem of this approach is that the insurer will have more chance of doing moral hazard since he is taking the full benefit of premiums that are fixed for £100,000. The problem would be more dangerous where the insured does not have any interest or has less interest than the amount that he is insuring at the day of taking policy. In this case, the policy would be treated as valid until the claim is made. Once the claim is made, the insurer will raise the issue and the insured will receive nothing or a lesser sum than he originally insured. If no claim is made the insurer will enjoy the benefit of the premiums. According to the view of Jacob Loshin, such an approach encourages the insurer to take such policies where there is a chance for him to avoid paying claims or pay less than the amount originally insured for. Consequently, this approach creates the chance of moral hazard. Moreover, this approach would cause an unfair result for the insured when taking out a policy for a large amount of money, paying premiums accordingly but subsequently the interest is lost or reduced at the day of claim. Since both moral hazard and unfairness are prohibited by *Shariah* principles⁸³ such approach cannot be applied in a *Takaful* contract.

Insurable Interest Must Exist both at the Time of Taking Policy and Claim

Under this approach the insured can get the insured amount only if the insurable interest exists both at the time of taking policy and claim. Accordingly, the creditor, in the above example, cannot recover the insured amount if he receives the full amount from the debtor before his death. Consequently, the chance of gambling and moral hazard is diminished. However, a new problem will be created where the debtor repays some of the debt amount, for instance £50,000 out of £100,000. In such circumstances, the question is how much should the insured receive from the insurer once the debtor dies. If he is allowed to receive the full amount, i.e. £100,000, then he is benefitted by the extra amount which he has already received from the debtor. Hence, the chance of gambling and moral hazard exists. If he is allowed to receive only the amount that is due from the debtor, i.e. £50,000, then the question is, why is he required to pay premiums for the full insured amount, i.e. for £100,000, after the repayment of £50,000?

The further problem with this approach, is that the insurer has a chance of moral hazard by claiming that the insured does not have insurable interest at the time of claim or his interest is reduced although he had insurable interest at the time of taking policy. The insurer, as stated above, will raise this issue once the claim is made, otherwise they will enjoy the premiums. Whereas, the insurer does not have such a chance of moral hazard in the first approach, since he has to pay the full insured amount once it is proved that the insured had insurable interest at the day of taking policy.

However, this last approach can be made *Shariah* compliant if some duties are imposed on the insured and insurer. An insurer should have the duty to take reasonable steps to ensure that the insured has sufficient insurable interest to enter into the contract. The insurer shall also take reasonable steps when determining the value of interest that can be insured. If the insurer fails to take reasonable steps and it is found that the insured did not have insurable interest, the contract is void and the insurer shall pay the premiums back including a small charge for keeping the insured out of pocket for a certain period. The parties should decide the charged

⁸⁰ *ibid* 474, 485, 487-488; See, the Law Commission and the Scottish Law Commission, *Insurance Contract Law: Issues Paper 4 Insurable Interest* (14 January 2008) para 4.3, 4.12.

⁸¹ *ibid* 474, 477, 490-493.

⁸² [2008]EWHC 76 (Comm).

⁸³ See, *The Holy Quran*, 55:7,8.

amount. If the insurer takes a policy for more than the actual interest, thereby breaching his duty of taking reasonable steps in determining the value of interest, he shall repay the excess premiums received for that excess coverage including a small charge which should be decided by the parties. The rest of the policy will still be valid. If the insurer finds the existence of an interest after taking reasonable steps whilst there was no insurable interest, the policy shall be void and the insurer has to pay the premiums back without any charge. Similarly if he takes the policy for a larger amount than the actual value of interest even after taking reasonable steps, he would repay the excess premiums back to the insured without any charge.

The insured will have the duty to inform the insurer if his interest is reduced or lost during the policy. Following this information the parties will amend the contract considering the existing level of interest. If the insured fails to inform the insurer in order to amend the contract the insurer will pay the excess premiums, taken from the day when the interest is lost or reduced, back to the insured taking a small charge for administrative cost.

The recommended duties would remove the problem of insuring higher amount than the actual interest or taking a policy where the insured does not have any interest. The insured's duty of informing the change in interest during the policy would also remove the chance of double recovery. Consequently, the chance of gambling and moral hazard both from the part of insured and insurer would be substantially reduced and as such the policy can be made *Shariah* compliant.

Required Time of Insurable Interest under English Insurance Law and the Steps to be Taken by a Takaful Operator

The Life Assurance Act 1774 imposes the first approach that has been mentioned above i.e. the insured must have insurable interest at the day of taking policy. It has been analysed above that this approach creates the chance of gambling and moral hazard both from the part of insured and insurer. Accordingly, this approach cannot comply with the *Shariah* principles. The Islamic insurers of the UK, therefore, have to incorporate certain terms in the contract to give effect to the recommendations suggested above to make their policies both English law and *Shariah* compliant.

The Position in Australia and the Steps to be Taken by a Takaful Operator

Since the Insurance Contracts Act 1984 does not require any insurable interest for a valid policy, *Takaful* operators can incorporate certain terms in the contract in order to decide the duty of the insured and insurer in dealing with the insurable interest. The terms, however, cannot stipulate that the contract would be void in the absence of insurable interest since that would breach the statute. In such circumstances the terms should state that the insurer will have the duty to take reasonable steps to ensure that the insured has sufficient insurable interest and to value that interest. If the insurer fails to take reasonable steps and it is found that the insured did not have insurable interest, the parties can cancel the contract by mutual agreement and the insurer shall pay the premiums back for breaching his duty under the contract, since there would not have been any contract if he had fulfilled his duty, with small amount of charge for keeping the insured out of pocket for some period. The parties should decide the charged amount. If the insured denies canceling the contract the insurer cannot avoid it due to the ruling of section 18(2) of the 1984 Act. Moreover, it is the insurer who breached his duty under the contract and the insured is not willing to take any action against that breach. In such cases, the insurer has to create a separate pool for this kind of policies which are valid by Australian law but invalid under *Shariah* principles. If there is any profit from this part of the pool they should donate that profit to the poor as stated above. If the insurer takes a policy for more than the actual interest breaching his duty of taking reasonable steps in determining the value of interest, the parties shall amend the contract by mutual agreement and reduce the insured amount. The insurer will repay the excess premiums received for that excess coverage including a small charge decided by the parties. If the insured denies amending the contract, the insurer has to separate the amount to the pool mentioned above. If the insurer finds the existence of interest after taking reasonable steps whilst there was no insurable interest, the parties will cancel the contract by mutual agreement and the insurer will pay only the premiums back for above-mentioned reason. The insurer will take the above-mentioned approach if the insured denies cancelling the contract. Similarly if he takes the policy for a larger amount than the actual value of interest even after taking reasonable steps, he would repay the excess premiums back amending the contract by mutual agreement. If the insured denies such action the above-mentioned approach should be followed.

The insured will have the duty to inform the insurer if his interest is lost or reduced during the policy. In the former case, the parties will cancel the contract and in the latter case, the parties will amend the contract considering the existing level of interest by mutual agreement. If the insured denies canceling or amending the

contract, the insurer has to take the above-mentioned approach of creating separate pool for such policies. If the insured breaches the terms of the contract by not informing the change of circumstances that lowered his interest, the insurer may cancel the contract from the day of the breach of the terms and pay the excess premiums back deducting a charge for administrative cost. In this case the insurer will get the remedy for breach of the terms of the contract by the insured who failed to inform the change of circumstances. Hence, the cancellation of the contract has no relation with the existence of insurable interest and as such this approach should not breach the statute. However, if the insured is interested to have a policy following the remaining interest he can take a fresh policy.

Conclusion

It is obvious that the demand for the *Takaful* in the world market is increasing. UK market has the most potential market outside the Muslim world. Academics argue that the Australia is also a potential market for this product.⁸⁴ The application of *Takaful* by Salaam Halal in the UK proves that its structure complies with the conventional insurance company regulations. This article, however, demonstrates that *Takaful* operators have to work through the consistencies and inconsistencies between the *Shariah* principles and the insurance contract law in the country in question. The article discusses the position of *Shariah* regarding the application of insurable interest in *Takaful* and analyses how it differs from the laws of the UK and Australia and provides guidelines how this problem can be solved. It has been suggested different approaches to be taken when considering the different rules adopted by the UK and Australia. For instance, a lack of insurable interest makes the insurance contract void in the UK, whilst the absence of insurable interest cannot be an issue for avoiding a policy in Australia. Under the *Shariah* principles the insurable interest should be a requirement for a valid *Takaful* in order to prevent gambling and moral hazard. In such circumstances the *Takaful* operators of the UK and Australia have to take different approaches in order to make their policy complaint with both *Shariah* and the law of the country in question. However, in recent years the Law Commission, have identified some new approaches in the application of insurable interest. The article also provides guidelines considering the inconsistencies between the *Shariah* and these new approaches so that the *Takaful* operators can get an idea how to tackle such new circumstances.

⁸⁴ Ann Newbrun and Sarah Awad, 'Takaful: can it be done in Australia?' <<http://www.mallesons.com/publications/marketAlerts/2009/InsuranceaneReinsuranceUpdate/Pages/Takaful-can-it-be-done-in-Australia.aspx>> accessed 31 October 2013. See also, Jamie Reid, 'Takaful Insurance an Introduction' <<http://www.finity.com.au/wp-content/uploads/2011/08/Takaful-Insurance.pdf>> accessed 1st April 2014.