Takaful: A review on performance, issues and challenges in Malaysia

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Takaful: A review on performance, issues and challenges in Malaysia

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Abstract: This paper aims to bring to attention the state of takaful or Shariah compliant insurance industry in Malaysia. It provides a review on takaful and its performance in Malaysia and highlights issues and challenges it faced. The review is undertaken through a detail desk study. The outcome of the review suggests that the penetration growth of takaful in Malaysia is relatively small in contrast to the conventional insurance, and that the takaful industry faces a series of constraints that require immediate attention if the industry is going to offer a reliable alternative to conventional insurance.

Key words: Insurance; Risk; Shariah; Takaful

1. Introduction

This paper discusses takaful or Shariah compliant insurance and assesses its potential in Malaysia. The aim of this study is to discuss prospects and challenges of takaful or Shariah compliant insurance in Malaysia. This paper has been prepared through extensive review of related published documents and statistics relevant. The paper is structured as follows:

i. Takaful: an overview
ii. Takaful and conventional insurance compared
iii. Takaful industry in Malaysia: key developments and market performance
iv. Takaful: prospects and challenges
v. Conclusion

2. Takaful: an overview

Shariah is an Islamic way of life, a set of guidance prescribed by Allah the Almighty to be followed by his servants. Shariah is derived from three principal sources: the Qur'an, Sunnah and fiqh, the first two are referred as the 'revealed' or primary sources and the third a 'non-revealed' or secondary source. The requirement for Muslims to adhere to the Shariah is stated in the Qur'an (The Holy Qur'an), thus;

'To each among you, we have prescribed a law and a clear way.' (Qur'an, Al-Maida: 48).

Takaful is an Arabic term derived from the root-word kafala. It means joint guarantee. In the context of insurance takaful is a Shariah compliant insurance.

Section 2 of Act 312, Takaful Act 1984 (Takaful Act, 1984), interprets takaful and takaful business respectively as;

'… a scheme based on brotherhood, solidarity, and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose.'

'… business of takaful whose aims and operation do not involve any element which is not approved by Shariah.'

Takaful is a promise between members of a group whereby the members firstly agree to establish a mutual fund and donate money into the fund, and secondly to provide a joint guarantee or protection among themselves against defined loss and/or damage. Consequently, if any member of the group suffers any of the defined loss and/or damage the member would receive compensation usually in the form of money or benefits drawn from the mutual fund.

The principles that make takaful Shariah compliant are; (i) tabarru' (donation), and (ii) ta'awun (mutual co-operation). The tabarru' from the takaful participants represents donation to the mutual fund and ta'awun when the group utilizes the mutual fund to compensate members in need, thus;

'… and co-operate you one another in righteousness and piety…' (Qur'an, Al-Maida: 2).

Essentially, takaful operates within the ambit of the Shariah i.e.

i. The subject matter and the intended objectives of the business are not un-lawful under the Shariah,
ii. The contract must be free from riba (usury), gharar (uncertainty) and maysir (gambling),
iii. The contract should not aim at deriving personal gain to one participant at the expense of the other participants,
iv. The participants must agree to co-operate for their own common good and must do so without coercion,

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v. The participants must agree to pay a contribution to help those who need assistance.

The origin of takaful, in the context of modern insurance scheme in Malaysia, began in June 1972 when the National Fatwa Committee of the Malaysian Islamic Affairs Council declared that the conventional insurance is not in compliance with the Shariah. The key non-compliance is that conventional insurance contains elements of riba, gharar and maysir that are prohibited by the Shariah. In 1985 a similar declaration was made by the Fiqh Academy of the Organization of Islamic Conferences. Consequently, Muslims in Malaysia and elsewhere need to seek alternative insurance that is in compliance with the Shariah i.e. takaful.

3. Takaful and conventional insurance compared

Table 1 lists some of the key differences between takaful and conventional insurance. Briefly, the key differences are:

i. Risk or potential loss and/or damage; in conventional insurance risk or potential loss is transferred entirely to the insurer while in takaful risk or potential loss is shared among the participants;

ii. There is a clear separation of funds under takaful i.e. the takaful funds formed from the donations made by the participants are managed by the operator, and the operator's own funds derived from fees for managing the takaful funds, whereas under the conventional insurance the funds are owned by the insurance operator;

iii. Takaful funds are not invested in investments that contain elements of riba, gharar and maysir whereas in conventional insurance there is no such restriction; and

iv. Under the Takaful Act 1984 a takaful operator is required to have a Shariah Advisory Board comprising of experts and Shariah scholars to ensure that the activities conducted by the operator in managing the takaful fund, etc. are in compliance with the Shariah.

Table 1: Comparison between takaful and conventional insurance (Alhabshi et al., 2012; Hassan, 2012; Jaffer, 2006; Rashid, 2010; Fauzi, 2010)

1. Similarities		
1. Both modes of insurances need payment from the insured to the insurer; in conventional it is called premium and under takaful it is called contributions in the form of donation (tabarru')		
2. The amount insured is payback to the insurer when certain events occur		
3. Both insurance policies have a significant investment or savings elements built into them		
2. Dissimilarities		
Concepts	Conventional Insurance	Takaful
Elements	• Operates under secular law • No requirement on spiritual sincerity and the concept of 'hereafter' is ignored	• Compliant with the Shariah • Elements of spiritual sincerity are essential aspect of the insurance contract, i.e. to achieve the pleasure of Allah and the concept of 'hereafter' is emphasized
Risks	• Transferred to one party • Borne by one entity (an individual or organization) – the Insured	• Sharing-risks between the group itself • The takaful participants agreed to assists those among them who incur any loss and share the reminder if any
Modus operandi	• Based solely on commercial factors	• Based on mutual cooperation • Based on mutual assistance and protection
Business operations/ activities	• Investments and other activities are not restricted as long as they comply with the relevant laws	• Free from the Shariah prohibitory elements (riba, gharar and maysir)
Payment of subscription	• Premium payment which creates an obligation against the Insurer on a sale & purchase contract	• Contributions payment in the form of donations through donation contract (tabarru')
Advisory board	•No requirement for compliance with the Shariah	• A Shariah Advisory Board ensures compliance with the Shariah (Takaful Act 1984)

4. Takaful industry in Malaysia: key development and market performance

Pursuant to the National Fatwa Committee of the Malaysian Islamic Affairs Council's declaration in 1972 that the conventional insurance is not in compliance with the Shariah Act 312 [8], Takaful Act 1984 was enacted.

In November 1984 Malaysia's first takaful operator, Syarikat Takaful Malaysia Berhad was formed and it commenced operation in August 1985. In 1997 a re-takaful operator was formed. To enhance self-regulation and to promote the interest of operators the Malaysian Takaful Association (MTA), a mandatory association required under the Takaful Act of 1984, was formed in 2002. All operators are required to be members of MTA before they can commence operations.

As at 2014 there are 11 registered takaful operators and 88,895 takaful agents (2005: 5 and 14,059 respectively) providing family and general takaful services in Malaysia. On 2nd September 2010 four joint ventures were issued new takaful licenses. The four joint ventures include several international operators (The Star, 2010). The names of the registered takaful operators are as shown in Table 2.

Table 2: Licensed takaful operators in Malaysia (Central Bank of Malaysia, 2014a)

No	Takaful operator	Year formed
1	Syarikat Takaful Malaysia Berhad	1984
2	Takaful Ikhlas Sdn Bhd	2002
3	Prudential BSN Takaful Berhad	2006
4	HSBC Amanah Takaful (M) Sdn Bhd	2006
5	Hong Leong Tokio Marine Takaful Berhad	2006
6	Hong Leong MSIG Takaful Berhad	2006
7	MAA Takaful Berhad	2006
8	Sun Life Malaysia Takaful Berhad	formerly known as CIMB Aviva Takaful Berhad; incorporated in January 2013
9	Etiqa Takaful Berhad	Formerly Takaful Nasional Sdn Bhd, assumed new name in 2007
10	AIA PUBLIC Takaful Bhd	2011
11	Great Eastern Takaful Berhad	2010

The net contributions income of Malaysia's takaful industry in 2014 stood at RM 6,330.6 million (2010: RM 4,421.8 million) and the total takaful fund assets stood at RM 22,746 million (2010: RM 14,720.5 million). In 2014 takaful represents 9.1% of the total assets of the insurance and takaful industry of Malaysia (2010: 7.4%) and the Malaysia's takaful operators paid RM 2,699 million in net benefits and claims payments (2010: RM 2,019.1 million).

Table 3 provides some key indicators of the takaful industry in Malaysia and Table 4 shows statistics on family takaful income and outgo and general takaful underwriting and operating results 2010-2014. Box 1 contains quotation from the Bank Negara Malaysia's overview on the performance of Malaysia's takaful industry.

5. Discussion

5.1. Takaful: Prospects and challenges

The takaful industry in Malaysia is only 32 years old but statistics provided herein before, key indicators published by the Bank Negara Malaysia (The Star, 2010) and commentaries provided by key industry players (The Star, 2010; Ghani, 2006; Bank Negara Malaysia, 2008; Ernst & Young, 2010) all point out to the fact that takaful has, since its origin in 1984, been enjoying relatively robust growth. Takaful has become an important component in the overall Shariah compliant financial system in Malaysia. However, takaful industry continues to face numerous challenges and issues in many aspects, notably low penetration rate, shortage of human capital, inadequate technology capabilities, ineffective governance practices, and lack of innovation in business model for new market niches (Deloitte, 2015).

Despite the robust growth, the penetration rate for takaful in Malaysia remained small i.e. about 10% when compared with conventional insurance which stands at about 40%. In addition, there remained many untapped areas of business within the takaful industry including microtakaful, medical and retirement products (The Star, 2010; Deloitte, 2015).

In the context of the construction industry, studies by Mohd Arif Iskandar (Durahim, 2010) and Puteri Nur Farah Naadia (Fauzi, 2010) suggest that contractors are not aware of the presence of takaful and they do not understand its concept and principles. They speculated that this could be among the reasons why market share of takaful for construction work in the overall construction insurance market in Malaysia is very small. For example, according to the Bank Negara Malaysia (Central Bank of Malaysia, 2014c) the premium income from Contractors' All Risks and Engineering (CAR) stood at RM 472.1 million in year 2014 (2010: RM 373.8 million) while that of takaful CAR stood at only RM 107.2 million in year 2014 (2010: RM 66 million). The small market share of takaful indicates that there is significant opportunity for future growth.

Globally, the takaful industry has been growing rapidly, appealing to both Muslims and non-Muslims. The industry is expected to grow by 15-20% annually, with contributions expected to reach USD20 billion by 2017. As at 2015, there are more than 110 takaful operators worldwide (Central Bank of Malaysia, 2015). The two major markets are South-east Asia and the Middle-East. According to Ernst & Young (EYGM, 2014) global takaful grew in 2014 to reach US$14 billion in 2014 from an estimated US$12.3 billion in 2013. In addition, Ernst & Young (EYGM, 2014) observed strong growth was recorded a still healthy growth rate of 14% over year 2012 to 2014 in family takaful in the Middle-east countries and Malaysia respectively. On the attraction of takaful to non-Mulims, Wan Zamzuri of MAA Takaful in Shabnam Mokhtar, (Mokhtar, 2008b) one of the operator in Malaysia, commented;

Table 3: Key indicators of the takaful industry of Malaysia, 2010 to 2014 (Central Bank of Malaysia, 2014b)

Key Indicator	Calendar Year				
	2010	2011	2012	2013	2014
Market Structure[1]					
No. of Registered Takaful Operators[2]	9	11	12	12	11
No. of Agents	74,089	100,308	105,552	77,804	64,169
Family	42,698	66,338	68,009	58,984	50,592
General	31,391	33,970	37,543	18,820	13,577
No. of Offices	106	207	213	215	129
No. of Employees	2,713	2,846	2,758	3,162	2,720
Net Contributions Income					
Total (RM million)	4,421.8	4,863.0	5,887.8	6,207.9	6,330.6
Combined Contributions (% of GNI)	0.6	0.6	0.7	0.7	0.6
Family (% of GNI)	0.5	0.1	0.3	0.2	0.1
General (% of GNI)	0.1	0.3	0.2	0.1	0.1
Per capita contributions (RM) on:					
Family[3]	119.8	127.3	155.1	160.8	157.5
General[4]	36.4	39.8	44.5	46.8	50.8
Net Benefits and Claims Payments					
Total (RM million)	2,019.1	2,185.4	2,263.4	2,706.8	2,699.0
Family	1,599.6	1,660.4	1,635.9	1,999.2	2,027.6
General	419.4	525.1	627.5	707.5	671.4
Takaful Fund Assets					
Total (RM million)	14,720.5	16,948.2	19,045.6	20,934.0	22,746.0
Family	12,461.2	14,377.2	16,289.8	17,952.0	19,619.0
General	2,259.2	2,571.0	2,755.9	2,982.0	3,127.0
% of GNI	2.0	2.0	2.1	2.2	2.2
% of total assets of the insurance and takaful industry	7.4	7.8	8.2	9.0	9.1

*Note

[1] As at 31 December 2014, [2] Direct Takaful operators, [3] As per revenue account, [4] Contributions on gross rate changed to participants without deduction for commission and brokerage, [5] GNI: Gross National Income, [6] Numbers may not necessarily add up due to rounding

Table 4: Family takaful income and outgo and general takaful underwriting and operating results 2010-2014 (Central Bank of Malaysia, 2014c)

Family takaful: Income and outgo					
Item	Calendar Year				
	2010	2011	2012	2013	2014
	RM million				
Total Income Net contributions, investments & profit on sale of assets and miscellaneous income	6,353.6	7,143.4	8,339.6	9,196.4	9,188.1
Outgo Net certificate benefits, net commissions, management expenses, loss on disposal of assets and other outgo	4,121.9	4,645.2	4,725.6	6,066.8	5,856.5
Excess of income over outgo	2,231.7	2,498.2	3,614.0	3,129.6	3,331.6
General takaful: Underwriting and operating results					
Underwriting profit	236.4	149.8	236.9	291.7	386.8
Investment income	100.7	124.3	141.9	153.4	163.8
Capital gains	23.1	56.2	68.9	114.9	34.8
Other income	25.8	47.8	11.2	12.5	8.8
Capital losses	0.3	1.4	0.1	0.1	10.5
Other outgo	19.3	14.4	53.7	27.0	46.3
Operating profit	366.3	362.3	405.1	545.4	537.3

'… at least 40% of our customers so far are non-Muslim. There are a few plus points for them, including surplus sharing and higher transparency in conducting business. Under our model, if at the end of the financial year there is a surplus in our risk investment account (i.e. fewer claims than reserves), we will share this at 50:50 ratio with the policyholders. Policyholders will get more if there is a surplus; whereas in conventional insurance, the company takes 100% of the surplus.'

On challenges facing the takaful industry in Malaysia, Jaffer, S., Farzana, Jabran, Unwin, L. (Jaffer, 2015) listed the following key challenges;

i. Competition with the takaful industry is immense. The competitive elements are in the form of groups of experienced players that are determined to sustain their market share and new players with strong financial support, backed with existing resources and international network. On the one hand, the entrance of more players means that competition will be steeper, but on the other hand customers could enjoy better services and pricing for the takaful products;
ii. Takaful operators must be able to effectively respond to customers' needs and demands as consumers have increasingly becoming more discerning and demanding better product choices, more efficient delivery channels and more customer friendly practices from takaful operators;
iii. The Malaysian government is committed to promote takaful and to make Malaysia a takaful and re-takaful hub in South-east Asia. Efforts are in place including the establishment of strong legal, regulatory and shari'ah framework governing the industry and the International Centre for Education in Islamic Finance or INCEIF to enhance capacity building. The takaful industry must chart clear strategic direction in order to achieve and sustain success especially on the enhancement of human capital, collaboration among operators in order to achieve common objectives of further enhancing the resilient and expansion of the industry including venturing overseas.

In addition, Shankar (] Laws of Malaysia Act 312 Takaful Act, 1984) identified business process as among the key challenges facing conventional insurers in dealing with takaful. Firstly, adoption of either mudarabah (profit sharing) or wakalah (agency) models instead of adopting a single business model as in conventional insurance where profit maximization for shareholders is key therefore require specialized IT system in addition to their existing IT set-up; secondly, the need for special accounts for participants i.e. the tabarru fund and investment fund and the need for the participants' contributions to be distributed into these two accounts thus the need for adequate and specific parameters, to cover claims to be considered, contributions received, payment models as well as long term policies; and in understanding Shariah principles and driving business based on them. Shankar (Laws of Malaysia Act 312 Takaful Act, 1984) suggests that 'it may be wise for conventional insurers to consider joining forces with existing takaful operators. The latter could be valuable in terms of leading the former in designing new takaful products.'

In the context of the construction industry, Puteri Nur Farah Naadia (Fauzi, 2010) listed the challenges facing the takaful industry to include the lack of knowledge among the key players of the construction industry on the concepts and principles of takaful as a consequent of the lack of promotion on takaful by the takaful operators. In the context of the global takaful industry, Ernst and Yong (EYGM, 2014) observed that the key challenge lies in the fact that profitability is under unprecedented stress due to the recent global financial crisis. Takaful operators are coping with depressed capital levels, distressed asset values and difficult capital markets. They observed that many operators are reviewing their strategies and financial plans focusing on;

i. Understanding risk-return implication of the chosen business model and aligning them with evolving and unique shari'ah regulatory frameworks,
ii. Business diversification and specialization with a view to improve risk understanding and pricing;
iii. Strengthening underwriting capacity and including new products, especially as customers move from variable structures to more traditional products;
iv. Investment discipline in the wake-up of steep decline in value of securities and returns;

Enhancing operating efficiency through cost management around customer acquisition, retention and servicing, and structured claims management process

6. Conclusion

Takaful is an insurance scheme that is Shariah compliant. Takaful in Malaysia and elsewhere is relatively young when compared to other sectors of the financial industry but it has enjoyed robust growth. However, despite the robust growth, the penetration rate for takaful in Malaysia and elsewhere remained small and this indicates that there is significant opportunity for future growth. There are challenges facing the takaful industry in Malaysia and elsewhere. The challenges range from competitive elements, business model and processes, changing customers' needs and demands for better product choices, more efficient delivery channels and more customer friendly practices from takaful operators, and having to cope with serious threat on profitability arising from the recent global financial crisis.

In the context of Malaysia, the government is committed to promote takaful and to make Malaysia a takaful and re-takaful hub in South-east Asia. This paper provided a brief on the takaful industry in Malaysia and elsewhere. Consequently, further and in-depth study is required.

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