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Chapter 11

TAKAFUL: INTRODUCTION

The takaful industry represents an important component in the overall Islamic financial system. Given its role in providing risk protection, the takaful industry offers a suite of financial products and services that complement the existing range available for consumers. In recognising its importance, focus has been given in developing a dynamic and vibrant takaful industry within our Islamic financial system. Where the industry is today has been an outcome of an accumulation of efforts in instituting a comprehensive Islamic financial landscape in Malaysia's financial system. A strong institutional infrastructure and effective legal, regulatory and Shariah framework are the underpinnings of our Islamic financial industry.

The growth of Islamic insurance or Takaful market is remarkable. Global gross Takaful contributions reached USD$8.3 billion in 2010, USD$12 billion in 2013 and continue to depict healthy growth. These contributions largely came from Saudi cooperatives, GCC and Southeast Asia countries. Takaful is also expanding rapidly in Malaysia. For clarity, the major focus of the chapters on Takaful in this book will be on Malaysia. Before proceeding, the meaning of Islamic insurance or takaful needs to be understood.

11.1 What is Takaful

Takaful originates from the Arabic word Kafalah which means ‘guaranteeing each other’ or ‘joint guarantee’. It is based on the principles of mutuality and co-operation, encompassing the elements of kindness, shared responsibility, joint indemnity, common interest and solidarity. Takaful is a pact amongst a group that agrees to donate contributions to a fund that is used to jointly indemnify covered losses incurred by the members. Although technically the concept of takaful revolves around mutuality and is founded on non-commercial basis principles, the operations and the funds are commonly managed by a Takaful operator on commercial basis.

Islamic insurance is introduced as alternative to conventional insurance as there are many elements prohibited in Islam in conventional insurance e.g. elements of excessive speculations and uncertainty, usury and investment in non-Shariah-compliant businesses.

Takaful is attractive to the Muslims as Takaful employs several Islamic elements such as ta’awun (mutual help), tabarru’at (willingly relinquish individual rights over the contributions paid, for collective benefits), profit-and-loss sharing and it does not seek to derive advantage at the costs of others. These elements make takaful attractive to the non-Muslims as well. Similar to Islamic banking and finance, the rate of penetration of Takaful among non-Muslim is surprisingly high, considering that Takaful is religion-based.

There has been a significant momentum in terms of growth and participation of takaful players in the global market. With its rapid annual growth of between 15-20%, the global takaful industry is one of the fastest growing components of the insurance market. Based on the 2007 Oliver Wyman Report, up to 20% of the takaful revenues originated from non-Muslim customers. The strong growth was also attributed by the increasing number of companies offering takaful services across jurisdictions. Currently, there are more than 300 takaful operators worldwide. There is also a growing participation of established conventional players in the takaful and retakaful industry. There are large conventional players from the UK, US and Germany that have set-up takaful or Retakaful companies within their groups. This is an important development. For comparison, the phenomenal rise of Islamic banking and finance in Malaysia is also partly due to the 'Islamic windows' through which conventional banks are allowed to be involved in the Islamic banking business.

This is an important development as the takaful industry would be able to benefit from the vast experience of its conventional counterpart. The conventional insurance would also benefit from the noble principles promoted by Takaful.

A strong and credible retakaful industry is a crucial contributor to promote the expansion of the takaful industry worldwide. Takaful possess high potential to expand because the insurance and takaful penetration in Muslim countries is less than 1% of the GDP.

Takaful simply means joint guarantee whereby a group of individuals or parties agree to mutually guarantee each other against a certain loss. Under the previous Takaful Act 1984, Takaful is defined 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.'

11.2 Divine authorities for takaful

Authorities from the Holy Quran

1. God intends easiness and not hardship:

The month of Ramadhan [is that] in which was revealed the Qur'an, a guidance for the people and clear proofs of guidance and criterion. So whoever sights [the new moon of] the month, let him fast it; and whoever is ill or on a journey - then an equal number of other days. Allah intends for you ease and does not intend for you hardship and [wants] for you to complete the period and to glorify Allah for that [to] which He has guided you; and perhaps you will be grateful.(2:185)

O you who have believed, when you rise to [perform] prayer, wash your faces and your forearms to the elbows and wipe over your heads and wash your feet to the ankles. And if you are in a state of janabah, then purify yourselves. But if you are ill or on a journey or one of you comes from the place of relieving himself or you have contacted women and do not find water, then seek clean earth and wipe over your faces and hands with it. Allah does not intend to make difficulty for you, but He intends to purify you and complete His favor upon you that you may be grateful. (5:6)

2. God want us to leave our family prepared and in good condition

And those who are taken in death among you and leave wives behind - for their wives is a bequest: maintenance for one year without turning [them] out. But if they leave [of their own accord], then there is no blame upon you for what they do with themselves in an acceptable way. And Allah is Exalted in Might and Wise. (2:240)

3. God prohibit us from consuming wealth using unjust method

‘O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent. And do not kill yourselves [or one another]. Indeed, Allah is to you ever Merciful.’ (4:29)

4. We are required to fulfill our contractual obligations

‘O you who have believed, fulfill [all] contracts.’ 5:1

5. Mutual cooperation is encouraged

‘O you who have believed, do not violate the rites of Allah or [the sanctity of] the sacred month or [neglect the marking of] the sacrificial animals and garlanding

[them] or [violate the safety of] those coming to the Sacred House seeking bounty from their Lord and [His] approval. But when you come out of ihram, then [you may] hunt. And do not let the hatred of a people for having obstructed you from al-Masjid al-Haram lead you to transgress. And cooperate in righteousness and piety, but do not cooperate in sin and aggression. And fear Allah ; indeed, Allah is severe in penalty.' 5:2

6. Only God know the unseen so we should mitigate risk and be prepared

'And with Him are the keys of the unseen; none knows them except Him. And He knows what is on the land and in the sea. Not a leaf falls but that He knows it. And no grain is there within the darknesses of the earth and no moist or dry [thing] but that it is [written] in a clear record.' (6:59)

7. We should be cautious and prepared

'And similarly, We awakened them that they might question one another. Said a speaker from among them, "How long have you remained [here]?" They said, "We have remained a day or part of a day." They said, "Your Lord is most knowing of how long you remained. So send one of you with this silver coin of yours to the city and let him look to which is the best of food and bring you provision from it and let him be cautious. And let no one be aware of you.' (18:19)

Authorities from the Hadith

1. The Prophet advised us to do our part before leaving the result to God: 'When the Holy Prophet asked a Bedouin Arab, who entered the mosque with his camel left outside untied, if his camel would run astray, he said: "Insha Allah". The Prophet then said: "Tie your camel first, then say Insha Allah". (narrated by Anas bin Malik, Sahih Bukhari).
2. "Whosoever removes a worldly hardship from a believer, Allah will remove from from him one of the hardships of thereafter. Whosoever alleviates the needy person, Allah will alleviate from him in this world and the next". (Translation of Sahih Muslim, Book 32, No.6250)
3. SahihBukhri, Volume 8, Book 73, Number 34: Narrated Sahl bin Sa'd: 'The Prophet said, "I and the person who looks after an orphan and provides for him, will be in Paradise like this," putting his index and middle fingers together.'
4. SahihBukhari, Volume 8, Book 73, Number 35: 'Narrated Safwan bin Salim: 'The Prophet said "The one who looks after and works for a widow and for a poor person, is like a warrior fighting for Allah's Cause or like a person who fasts during the day and prays all the night." Narrated Abu Huraira that the Prophet said as above.'

5. Narrated by Amir ibnSa'adibnAbiWaqas (r.a.) that the Holy Prophet (s.a.w) said: Verily it is better for you to leave your offspring wealthy than to leave them poor asking others for help" (SahihBukhari: Kitab al-Fara'id)
6. Nobody will enter Paradise if he does not protect his neighbor who is in distress (Reported by Ahmad IbnHanbal)

Practices of Companions

The concept of life insurance can be seen in the doctrine of al-Aqilah. During the later stage of the period of the second caliph,Sayyidina Umar, the Caliph, directed that in the various districts of the State, lists of Muslim brothers-in-armsshould be drawn up. The people whose names were contained in those lists owed each other mutual assistance orco-operation and had to contribute to the payment of diyat (bloodwit) for manslaughter committed by one of their members of their own tribe. This was how Sayyidina Umar further developed the practices of the doctrine of al-Aqilah.

11.3 History of insurance and takaful

No	Year	Event
	2800 BC	Babylonian and China: The concept of general insurance to cover business and trade risk can be traced back to ancient Chinese and Babylonian civilization. The businessmen and traders used to pool their business assets and stocks together and agreed that unfortunate merchant or trader would be compensated accordingly.
	1750 BC	The Babylonians developed an insurance system which was recorded in the famous Code of Hammurabi, c. 1750 BC, and practiced by early Mediterranean sailing merchants.
	600 BC	Ancient Greek and Roman: The Greeks and Romans introduced the origins of health and life insurance c. 600 BCE when they created guilds called "benevolent societies" which cared for the families of deceased members, as well as paying funeral expenses of members.
	Ancient Persia	Achaemenian monarchs of Ancient Persia were the first to insure their people and made it official by registering the insuring process in governmental notary offices. The insurance tradition was performed each year in Norouz (beginning of the Iranian New Year); the heads of different ethnic groups as well as others willing to take part, presented gifts to the monarch. The most important gift was presented during a special

		ceremony. When a gift was worth more than 10,000 Derrik (Achaemenian gold coin) the issue was registered in a special office. This was advantageous to those who presented such special gifts. For others, the presents were fairly assessed by the confidants of the court. Then the assessment was registered in special offices. The purpose of registering was that whenever the person who presented the gift registered by the court was in trouble, the monarch and the court would help him. Jahez, a historian and writer, writes in one of his books on ancient Iran: "[W]henever the owner of the present is in trouble or wants to construct a building, set up a feast, have his children married, etc. the one in charge of this in the court would check the registration. If the registered amount exceeded 10,000 Derrik, he or she would receive an amount of twice as much."
	4th century	Ancient Athenian: The ancient Athenian "maritime loan" advanced money for voyages with repayment being cancelled if the ship was lost. In the 4th century BC, rates for the loans differed according to safe or dangerous times of year, implying an intuitive pricing of risk with an effect similar to insurance.
	Ancient Arab	Under the ancient Arab tribal custom, each tribe or clan was united as one unit and any loss or suffering of its own members was seen and considered as the loss of the entire tribe. In case of murder, the chief can demand that the murderer be given up for retaliation. However, this can lead to full-scale war due to the chain of reactions. To avoid this, the concept of blood money or compensation was introduced. It is believed that the concept of life insurance partly originated from this.
	13th century	The first 'modern' insurance contract executed in Genoa. Separate insurance contracts (i.e., insurance policies not bundled with loans or other kinds of contracts) were invented in Genoa, as were insurance pools backed by pledges of landed estates. These new insurance contracts allowed insurance to be separated from investment, a separation of roles that first proved useful in marine insurance.
	14th century	The Italian merchants introduced marine insurance to England
	1583	The first case of 'modern' life insurance occurred in England involving one William Gybbon
	17th century	Some forms of insurance had developed in London by the early decades of the 17th century. For example, the will of the English colonist Robert Hayman mentions two "policies of insurance" taken out with the diocesan Chancellor of London, Arthur Duck. Of the value of £100 each, one relates to the safe arrival of Hayman's ship in

		Guyana and the other is in regard to "one hundred pounds assured by the said Doctor Arthur Ducke on my life". Hayman's will was signed and sealed on 17 November 1628 but not proved until 1633. The Lloyds of London, the international centre for insurance later on begin to cover ships and cargoes. British merchants and shipowners began to meet at a coffeehouse near Lombard Street in London. The coffeehouse was called Lloyd's and the parties made an agreement to mutually share in the profits and losses of sea voyages.
	1666	Insurance as we know it today can be traced to the Great Fire of London, which in 1666 devoured more than 13,000 houses. The devastating effects of the fire converted the development of insurance "from a matter of convenience into one of urgency, a change of opinion reflected in Sir Christopher Wren's inclusion of a site for 'the Insurance Office' in his new plan for London in 1667."
	1680	Edward Lloyd opened a coffee house that became a popular haunt of ship owners, merchants, and ships' captains, and thereby a reliable source of the latest shipping news. It became the meeting place for parties wishing to insure cargoes and ships, and those willing to underwrite such ventures. Today, Lloyd's of London remains the leading market (note that it is an insurance market rather than a company) for marine and other specialist types of insurance, but it operates rather differently than the more familiar kinds of insurance.
	1693	The mortality table was developed by Edmund Halley and this significantly assist the life insurance industry
	1972	National Fatwa Committee in Malaysia, at its gathering on 15th June 1972 resolved "… that the life insurance as operated and provided by the present-day insurance companies is a commercial transaction containing the element of gharar is void and contravened the Shariah and therefore Haram…'
	1976	Mecca: First international conference on Islamic economic
	1977	Saudi Arabia: Fatwa issued by higher council in favour of Islamic insurance model
	1979	Sudan: The first Islamic insurance (or takaful) company, 'the Islamic Insurance Company of Sudan' was established.
	1979	Islamic Insurance Company Ltd started operating to cater the insurance needs of its parent company, 'Faisal Islamic Bank'.
	1980	Saudi Arabia: Arab Islamic Insurance Company Ltd was

		established to cater the insurance needs of 'DallahBarakah Group' with its head office in Jeddah, later relocated to UAE.
	1981	Switzerland: Dar al Mal al Islamic Trust formed to setup Islamic banks and Takaful companies.
	1982	A 'Task Force to Study the Establishment of an Insurance Company in Malaysia' was established by the Government of Malaysia to study the feasibility of introducing takaful in Malaysia.
	1983	Luxemburg: Takaful launched with the establishment of Takaful S.A
	1983	Geneva: 'Darul-Mal al-Islamic (DMI) in Geneva come out with the Framework of Certificate for Family Takaful'.
	1984	Malaysia: A Task Force recommended that an insurance company that is shariah-compliant could be introduced in Malaysia. A new Act is also recommended as the Malaysian Insurance Act 1967 is not compatible with shariah.
	1984	Malaysia: Takaful Act 1984 was introduced, the first in the world.
	1985	Tunisia: Re-Takaful launched with the establishment of PT Syarikat Takaful
	1985	Jeddah: The Fiqh Academy of the OIC issued a resolution in its assembly in Jeddah on 22nd to 28th December 1985 that '… the contract of commercial insurance, with a fixed periodical premium transacted by insurance companies is based on a haram contract..
	1990	the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was created to establish industry accounting and auditing standards.
	1995	Qatar: Takaful launched with the establishment of Qatar Islamic Insurance Company
	1995	Singapore: Takaful launched with the establishment of Syarikat Takaful
	1997	Dubai: Takaful launched with the establishment of Dubai Islamic insurance company
	2002	Malaysia: The Malaysia-based Islamic Financial Services Board (IFSB) was established as an international standard-setting body for Islamic financial institutions.
	2003	Pakistan: Takaful launched with the establishment of First Takaful Company
	2005	Bahrain: Bahrain Monetary Authority enacted rules for Takaful companies
	2008	Bahrain: Takaful launched with the establishment of Salaam insurance.
	2009	Malaysia: Islamic Financial Services Board issued guidelines on Takaful governance, Shariah governance

	2010	Bahrain: AAOIFI's Islamic Insurance Standards No.26 was issued
	2010	Brunei: Takaful launched with the establishment of Takaful Brunei Darussalam
	2011	Malaysia: Guidelines were issued on solvency for Takaful
	2011	Kenya: Takaful launched with the establishment of Takaful Insurance Africa
	2011	Palestine: Takaful launched with the establishment of al-Takaful Palestinian Insurance
	2012	Indonesia: Indonesia is emerging as a significant Takaful market, overtaking several of the GCC countries in Gross Written Contributions (GWC). Along with Malaysia and Brunei, the other two important Takaful markets in South East Asia, the region accounts for more than USD 2 billion in the total GWC.

11.4 History of Takaful in Malaysia

Before the formation of Malaysia, states in the peninsular were already exposed to the concept of insurance. During the 18th and 19th centuries, trading firms and agency houses acted as agents for insurance companies from the United Kingdoms. The role of insurance during that period was mainly to protect the Western interest and the interest of a small group of local elites.

Due to the divide and rule policy, the (Muslim) Malays were discouraged from participating in the business sector so that the local Malays will remain economically poor and subservient to the Western power, with the exception of a handful of Malay elites. Due to the weak economic condition of the Malays which formed the majority of the Muslim people, the development of Islamic banking and finance, together with Islamic insurance were halted.

Upon independence, there was an effort to establish domestic insurance companies. The early 1960's saw the growth of many life and general insurance companies. Some of these companies operated on an unsound basis with improper underwriting guidelines.

The Government subsequently intervened and the Insurance Act 1963 was introduced. Under the Act, the general conduct and supervision of the insurance industry was vested in the Director-General of Insurance under the Ministry of Finance. The introduction of Islamic banking and takaful is part of the Islamization policy of Malaysia in which the legal, social and economic conditions of the society were harmonized with Islamic principles, while maintaining and respecting the uniqueness and rights of the non-Muslim community.

The external relationship of Malaysia under Tunku Abdul Rahman, the first Prime Minister, was markedly pro-Western. After the admission of Malaysia into the OIC in 1972, the subsequent Prime Ministers proceed with a foreign and domestic policy that is pro-Islam. Domestically, Malaysia promoted Islamic values and stressed the role of Islam in national development and in the promotion of the personal economic well-beings of the community.

The Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia, at its meeting on 15 June 1972 discussed and deliberated on the issue of Life Insurance and resolved:

> 'that Life Insurance provided by present-day insurance companies is a business transaction which is voidable because it contradicts the Islamic business principles in view that the contract contains the elements of *gharar*, *maysir* and *riba'*.

The Takaful Act 1984 was enacted and subsequently the first Takaful company namely Syarikat Takaful Malaysia Bhd was formed in 1984.

In 1982, a committee, Badan Petugas Khas (Special Task Force) was set up to study the feasibility of setting up Islamic insurance in Malaysia. The committee concluded that it is feasible and practical.

In 1985, a fatwa was issued that the conventional insurance was largely haram. The Islamic Fiqh Academy of the Organisation of Islamic Conference in December 1985 resolved that:

> 'The Commercial Insurance Contract, which a fixed periodical premium, which is commonly used by commercial insurance companies, is a contract which contains major elements of risks, which voids the contract and therefore, is prohibited (haram) according to the Shariah.'

The Academy invites the Muslims countries to work on establishing co-operative insurance institutions and co-operative entities for the re-insurance, in order to liberate the Islamic economy from the exploitation and violation of the system which Allah has chosen for this Ummah.

The takaful industry in Malaysia has witnessed significant transformation inthe last two decades with the increase in number of players and theexpansion of business scope and product range. The rapid expansion of theindustry warrants for an operational framework to be clearly laid out to guidethetakaful operators.

The evolution of the takaful industry in Malaysia has been a progressive one since its inception more than two decades ago. There has been significant progress amidst the orderly development of the takaful industry, which growth is underpinned by the holistic and pragmatic approach taken in developing the Islamic financial industry. The market has become more diverse, as there has been tremendous increase in the number of takaful operators operating in Malaysia, where from having a single takaful operator in 1984, we now have 9 takaful operators, 4 retakaful operators and one international takaful operator. In Labuan International Business and Financial Centre, there is also strong presence of the takaful industry, where its takaful market comprises 14 retakaful operators. The market segment for takaful has also widened over the years to meet the financial needs of the economy as its appeals and value propositions have transcended beyond religious reasons. Product offerings by takaful operators have further broadened to cater to the differentiated needs of customers, with family takaful products now dominating the market with a share of 78 percent of net contribution, as compared to general takaful products that dominated a share of 63 percent back in 1984.

Globally, Malaysia also signifies its presence in the takaful market, being the second largest takaful market in the world as its total assets of US$3.2 billion dominated 26 percent of total global takaful assets in 2009. Whilst sustaining the current pace of development, growth prospect remains strong for the takaful sector, in view of the large untapped potential, where out of the 53.5 percent market penetration rate for both takaful and insurance, the market penetration rate for takaful was merely 10.9 percent in September 2010.

The insurance and takaful sectors have seen positive and continuous growth over the last five years. In 2011, 67 out of 100 Malaysians had some form of life insurance or family takaful coverage as compared to only 59 out of 100 Malaysians in 2006.

A strong institutional infrastructure and effective legal, regulatory and Shariah framework are the underpinnings of our Islamic financial industry. In our pursuit to develop Islamic finance, the recent enhancement to the Central Banking Act has accorded formal recognition to the existence of Islamic finance as an arm of the dual financial system, thereby giving significance and due prominence to Islamic finance. Moving forward, a number of initiatives are planned to further enhance the competitiveness and growth momentum of the takaful industry, emphasising on enhancement of the regulatory and supervisory framework and the Shariah governance framework. Such initiatives are laid down for industry players to capitalise on, to achieve sustainable success and to unleash their potential gains both locally and abroad.

The takaful contract defines a unique relationship between the takaful operators and participants. I t requires takaful operators to duly observe fundamental obligations towards participants, particularly in terms of adhering to Shariah principles, undertaking fiduciary duties and meeting prudential standards. These obligations are to be consistently met in an increasingly challenging environment where there are variation in business practices, differences in opinions surrounding the operations of takaful, competition and changing market and economic conditions. Business operations would haveto be effectively managed to meet these challenges, to ensure that takaful operators are able to manage the various stakeholders' interest without compromising prudence. The discharge of fiduciary duties and responsibilities can be met by putting in place appropriate business conduct, effective and efficient systems, processes and controls, including good governance and oversight structures, complemented by competent and qualified persons.

Takaful operators are also expected to conduct operations in a prudent and ethical manner, guided by prevailing legislations, requirements and guidelines issued by Bank Negara Malaysia (Bank). To further promote the orderly growth of takaful business, the Guidelines on Takaful Operational Framework (the Guidelines) is issued, outlining parameters to govern operational processes of takaful operators and defining in detail where necessary, the various rules and requirements for takaful operators. It is envisaged that the Guidelines will promote the sustainability of takaful operations, business expansion and innovations and concurrently fulfil the prudential requirement expected by the regulatory authority.

There are some broad developments within the economy and the financial sector that will expand the opportunity for growth in the provision of independent financial advisory services. First, the insurance and takaful sectors have seen positive and continuous growth over the last five years, with total insurance premiums transacted and takaful contributions recording an average annual growth of 4.9%, with annual growth peaking at 13% in 2010. In terms of insurance penetration, in 2011, 67 out of 100 Malaysians had some form of life insurance or family takaful coverage as compared to only 59 out of 100 Malaysians in 2006. This means there remains a large untapped segment of the population with no life insurance or family takaful protection that the profession can further develop. Second, in terms of distribution channels, the agency force is still the dominant intermediation point for the insurance industry. At present, the market share of financial advisers as a delivery channel is still low and therefore, the prospect of growth is tremendous.

The prominence of the agency force as a delivery channel of choice for the distribution of life insurance business is evidenced from the more than 10% growth in the number of life insurance agents enrolled between 2006 and 2011. Consistent with the increase in the agency force, the expenditure dedicated to maintain this delivery channel also remained significant, with commissions and agency remunerations consistently accounting for more than 70% of the net investment income of the industry.

This trend reflects the attractive payouts a productive agent can potentially earn, although the industry's commission structure is bound by the limits specified in the operating costs control guideline (OCC Guideline) issued by the Bank. Benchmarked against selected countries within the region which do not regulate commission payment, the commission rate currently earned by Malaysian agents remains relatively high compared to the benchmarked rates of between 140% to 150%, as seen in other jurisdictions. This excludes other agency-related benefits which are also allowable under the OCC guideline.

Strong Malaysian Government Support

The Malaysian government provides tax incentives and other measures to encourage commercial banks operating in Malaysia to set up full-fledged Islamic banking subsidiaries. BNM uses its Malaysia International Islamic Financial Center Initiative to provide special tax and regulatory treatment, scholarships, and efforts to work toward mutual recognition of Islamic banking and takaful (Islamic insurance) practices. This offers a ten-year tax exemption on Islamic financial products in foreign currencies and tax relief for Islamic Finance studies. Expatriate Islamic finance experts are exempted from paying Malaysian income tax in an effort to better enable Malaysia to attract foreign talent. Foreign institutions can hold 70% equity ownership in domestic Islamic banks.

The Government continues to promote takaful as part of its strategy to make Malaysia a global hub for Islamic financial services, including through tax breaks and incentives. Companies wishing to offer takaful need a separate license. Foreign investors are permitted to own 49% of takaful joint ventures. International takaful operators, both domestic and foreign, may apply for licenses to conduct business in international currencies, either as incorporated entities or as branches. Currently, AIA Takaful International Bhd is the sole foreign-owned international takaful operator in Malaysia. Bank Negara is working with qualified local and foreign insurers to provide "re-takaful" (reinsurance under Islamic principles) services in Malaysia and to make Malaysia their center for re-takaful activities. New re-takaful operators will be given flexibility to conduct business in the country as a subsidiary or branch.

Malaysia has five international Islamic fund management firms. The government provides tax incentives for existing stock brokerage firms to set up Islamic brokerage subsidiaries and recently issued three new licenses to high profile brokerage firms, including U.S. firms Goldman Sachs and Citibank Securities, which the government hopes will attract Middle Eastern capital to invest in Malaysia. There are no restrictions on the ability of wholly foreign-owned Islamic fund management companies to invest assets abroad. Fees received from the management of Islamic funds are tax-exempt for ten years.

11.5 Differences between takaful and insurance

No	Characteristics	Insurance	Takaful
	Nature	Secular in nature, no religious consideration, solely profit-motivated	Based on the Holy Quran, the Sunnah of the Prophet and the ijtihad of the scholars
	Elements	No restriction	No elements of gharar, maisir, riba and other prohibited elements
	Contract	No restriction	Usually based on mudarabah, wakalah, waqf, tabarru’
	Nature of company/operator	Guarantor/Insurer	Mutual/joint guarantee by participants
	Fund ownership	The fund belongs to the Company though separation of assets is maintained between the Shareholders and the policy holder.	The fund belongs to the Participants and managed by the Takaful Operator for a legitimate consideration for the services rendered.
	Premium/ Contribution	Price in return of guarantee of cover	Tabarru’ (donation) into takaful fund
	Risk	Transferred to insurer	Mutually covered by participants
	Indemnity	Insurer’s fund	Participants’ fund (tabarru’)
	Operating expenses	Insurance Fund (premium)	Shareholders’ Fund (Mudarabah model) / contribution as fixed up-front charges (wakalah model)
	Investment	No restriction except imposed for prudential reasons	Shariah-compliant investment only
	Account treatment	For General insurance the paid premium is credited into the General Insurance Account. In Life insurance the premium is credited into the Life Insurance Account	For General Takaful the account is Tabarru’ means donation. For Family Takaful, there are two accounts, PA treated in line with principles of Mudarabah, while PSA treated in line with the basis of Tabarru’
	Fund	No separation / segregation of Insurance fund and Shareholders’ Fund	Separation of takaful fund and Shareholders’ Fund

	Zakat	Not applicable	Obligatory
	Shariah Council	Not applicable	Obligatory
	Religious Supervisory	There is no Religious Supervisory in Insurance	Religious Supervisory is made mandatory by the Takaful Act 1984
	Operating profit	Belong to shareholders	Shared between participants and operator based on profit-sharing principles (al-Mudarabah)
	Statutory Requirement		

11.6 Benefits of takaful

For operators, the Takaful industry is currently concentrated in limited markets, segments and business lines. However, there is immense potential. The share of Islamic finance in Malaysia is around 22% whereas its Takaful share is merely 10% respectively. Takaful has at least 10% of the known Shariah-inclined market that they have not yet tapped.

Rejection of the element of excessive Uncertainty (gharar)

Conventional insurance is a contract between the insurer and the insured, but this contract doesn't explicitly describe its outcome for either the insurer or the insured. And sharia doesn't allow the sale of contracts that are based on uncertainty.

The conventional insurer has the assurance of receiving a premium each month but faces uncertainty regarding when and whether the insured will make a claim. Likewise, the insured may or may not incur losses or damages to prompt a claim.

In addition, when an insurance claim does occur, neither party knows in advance how much may be paid to the insured (or even whether the insurer will pay a cent). The insurer considers many variables when documenting an insurance claim, so predicting what the outcome may be for either party is impossible.

The bottom line: Islamic scholars agree that conventional insurance contracts are based on uncertainty, which means they aren't sharia-compliant.

Rejection of gambling element

Going hand-in-hand with uncertainty is the fact that conventional insurance has characteristics of gambling. The conventional insurer receives huge amounts of money from the insured in the form of premium payments.

Will the insurer be able to hold onto that money? Or will some sort of disaster strike (tornado, wildfire, flood . . . pick a weather event) that results in the insurer paying out every dime of the premiums and then some?

When few claims are filed, the insurer wins (and the insured lose their premiums). When loads of claims are filed, the insured get some payback for their premiums (and the insurer may be in trouble).

Most Islamic scholars generally agree that conventional insurance products involve gambling and aren't sharia-compliant.

Rejection of usury

Another reason that Islamic law prohibits conventional insurance products is that their transactions involve interest. Interest generally comes into play in two ways:

Insurance companies need to make sure they can pay their customers' potential future claims, so they rarely let the premiums they collect sit in a cash account. Instead, they invest the premiums in interest-bearing fixed income instruments such as conventional bonds.

If the insured files a substantial claim, she may receive an amount from the insurer that totals more than the premiums she has paid. Most Islamic scholars consider any excess amount paid by a conventional insurer to be interest.

Keep in mind that someone who purchases a takaful product can also receive an amount that exceeds the total contributions she pays in. In that case, the excess amount is not considered interest.

The difference is not just semantics; the difference lies in the structure of a takaful fund and the transfer of risk (which is quite distinct from a conventional insurance product).

Chapter 16

TAKAFUL LEGAL AND REGULATORY FRAMEWORK

16.1 Legislation

To enable the BNM to meet the objectives of a central bank, it is vested with comprehensive legal powers under the following legislation to regulate and supervise the financial system. These pieces of legislation includes:

1. Central Bank of Malaysia Act 2009
   An Act to provide for the continued existence of the Central Bank of Malaysia and for the administration, objects, functions and powers of the Bank, for consequential or incidental matters.

2. Islamic Financial Services Act 2013
   An Act to provide for the regulation and supervision of Islamic financial institutions, payment systems and other relevant entities and the oversight of the Islamic money market and Islamic foreign exchange market to promote financial stability and compliance with Shariah and for related, consequential or incidental matters.

3. Financial Services Act 2013
   An Act to provide for the regulation and supervision of financial institutions, payment systems and other relevant entities and the oversight of the money market and foreign exchange market to promote financial stability and for related, consequential or incidental matters.

4. Exchange Control Act 1953
   An Act to confer powers, and impose duties and restrictions in relation to gold, currency, payments, securities, debts, and the import, export, transfer and settlement of property, and for purposes connected with the matters aforesaid.

5. Banking and Financial Institutions Act 1989 (BAFIA)
   An Act to provide new laws for the licensing and regulation of institutions carrying on banking, finance company, merchant banking, discount house and money-broking businesses, for the regulation of institutions carrying on certain other financial businesses, and for matters incidental thereto or connected therewith.

6. Islamic Banking Act 1983
   An Act to provide for the licensing and regulation of Islamic banking business.

7. Insurance Act 1996
   An Act to provide new laws for the licensing and regulation of insurance business, insurance broking business, adjusting business and financial advisory business and for other related purposes.

8. Takaful Act 1984
An Act to provide for the regulation of takaful business in Malaysia and for other purposes relating to or connected with takaful.

9. Development Financial Institutions Act 2002 (Act 618)
The DFIA which came into force on 15 February 2002 focuses on promoting the development of effective and efficient development financial institutions (DFIs) to ensure that the roles, objectives and activities of the DFIs are consistent with the Government policies and that the mandated roles are effectively and efficiently implemented. DFIA also emphasises on efficient management and effective corporate governance, provides a comprehensive supervision mechanism and mechanism to strengthen the financial position of DFIs through the specification of prudential requirements.

10. Anti-Money Laundering and Anti-Terrorism Financing Act 2001
This renamed and revised Act which came into force on 15 January 2002, is to provide for the offence of money laundering, the measures to be taken for the prevention of money laundering and terrorism financing offences and to provide for the forfeiture of terrorist property and property involved in, or derived from, money laundering and terrorism financing offences, and for matters incidental thereto and connected therewith.

11. Payment Systems Act 2003 (Act 627)
An Act to make provisions for the regulation and supervision of payment systems and payment instruments and for matters connected therewith. Came into force on 1 Nov 2003.

12. Money Services Business Act 2011
An Act to provide for the licensing, regulation and supervision of money services business and to provide for related matters.

13. Government Funding Act 1983
An Act to provide for the raising of funds by the Government of Malaysia in accordance with the Syariah principles and to provide for matters incidental thereto or connected therewith.

16.2 BNM GUIDELINES

Capital Adequacy

1. Requirements on Margin of Insolvency
2. Guidelines on Dynamic Solvency Testing
3. Minimum Paid-up Capital Requirement for Takaful Operators
4. Risk-Based Capital Framework for Insurers

5. Guidelines on Internal Capital Adequacy Assessment Process (ICAPP) for Insurers
6. Risk-Based Capital Framework for Takaful Operators

Financial Reporting

1. Guidelines on Financial Reporting for Insurers
2. Guidelines on Financial Reporting for Takaful Operators

Anti-Money Laundering

1. Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) Sectoral Guidelines 2 for Insurance and Takaful Industries
2. Anti-Money Laundering Act 2001
3. Standard Guidelines on Anti-Money Laundering and Counter Financing of Terrorism

Prudential Limit & Standard

1. Guidelines on Stress Testing for Takaful Operators
2. Guidelines on Stress Testing for Insurers
3. Guidelines on Related Party Transactions for Takaful Operators
4. Guidelines on the Role of the Appointed Actuary
5. Guidelines on Directorship for Takaful Operators
6. Guidelines on Related-Party Transactions (Consolidated)
7. Guidelines on Internet Insurance
8. Guidelines for Audit Committees
9. Guidelines on Financial Condition Report
10. Guidelines on Fit and Proper for Key Responsible Persons
11. Minimum Standards for Prudential Management of Insurers (Consolidated)
12. Prudential Framework of Corporate Governance for Insurers
13. .Internet Takaful
14. Revised Guidelines on Derivatives for Insurers
15. Appointment of External Auditors by Takaful & Retakaful Operators Guidelines on Application for Registration and Operation of Retakaful Operator. This supersedes the two previous guidelines below :
    i. Guidelines on Establishment of Retakaful Operator in Malaysia; and
    ii. Guidelines on Procedures for the Establishment , Registration and Operation of Retakaful Operator
16. Appointment of External Auditors by Insurers
17. Guidelines on Investment Management for Takaful Operators

18. Guidelines on Introduction of New Products for Insurance Companies and Takaful Operators
19. Guidelines on Takaful Operational Framework
20. Guidelines on Valuation Basis for Liabilities of General Takaful Business
21. Guidelines on Valuation Basis for Liabilities of Family Takaful Business
22. Guidelines on Data Management and MIS Framework **updated 2011/09/05
23. Guidelines on Ibra' (Rebate) for Sale-Based Financing
24. Risk Governance * Same guideline applies to Banking, Insurance & Takaful and Development Financial Institutions
25. Appointed Actuary: Appointment and Duties Concept Paper

16.3 Supervisory Issues

Malaysia is well known for its comprehensive supervisory mechanism. For any regulation to be effective it must fully appreciate the differences between insurance and takaful. Bank Negara Malaysia places great importance on ensuring that the overall Islamic financial system operates in accordance with Shariah principles. This is to be achieved through the Shariah governance infrastructure comprising two vital components: a centralized Shariah Advisory Council (SAC) at BNM and an internal Shariah committee formed in each respective Islamic financial institutions (IFI). Indeed, a takaful operator is an IFI, hence, compliance with Shariah is paramount and mandatory.

Under the Takaful Act 1984, BNM can refuse to grant an operator a takaful license if the company's Articles of Association did not provide for the establishment of a Shariah advisory body or Shariah committee. Further, under section 11 (1)(a) of the Act, the registration of an operator either wholly or in respect of a class of business, will be revoked if the operator is pursuing aims or carrying an operation involving any elements that is not approved by Shariah.

Bank Negara Malaysia has established the Shariah Advisory Council under Section 51 of the Central Bank of Malaysia Act 2009. Under the Act, the SAC is positioned as the highest authority for the determination of Islamic law for the purposes of Islamic financial business. The mandates of the SAC, among others, are to ascertain the relevant Islamic law on any financial matter and issue a ruling upon reference made to it, as well as to advise BNM and the IFI concerned on any Shariah issues relating to Islamic financial business operations, activities or transactions. The SAC, will be referred to by the court or arbitrator in disputes involving Shariah issues in Islamic banking, finance and takaful cases.

Shariah compliance of takaful operation and its scope is a subjective matter and is determined by the operator's Shariah committee and approved by the SAC. The operator's Shariah Committee is expected to assist the SAC on any matters referred by an IFI. Upon obtaining any advice of the SAC, the Shariah Committee will ensure that all the SAC's decisions are properly implemented by the Islamic financial institutions.

A new guideline issued by Bank Negara Malaysia took effect in January 2011, with respect to Shariah governance in Islamic banks and takaful operations. The revised Shariah governance in Islamic banks and takaful operations. The revised Shariah Governance Framework for Islamic Financial Institutions also outlines the Shariah committee's functions relating to Shariah review, audit, tisk management and research.

Under this guideline, the takaful operator shall recognize the independence of the Shariah committee and ensure that the committee is free from any undue influence that would hamper it from exercising objective judgment in deliberating issues brought before it. Correspondingly, the Shariah committee is expected to make sound decisions on Shariah matters in an independence and objective manner.

The Shariah committee shall report directly to the takaful operator board and regularly inform the board on relevant Shariah matters. The board shall ensure that decisions made by the Shariah committee are duly observed and implemented by the IFI. Decisions made by the Shariah committee should not be set aside or modified unilaterally without its consent.

The Shariah committee shall have access to accurate, timely and complete information from the management. If the information provided is insufficient, the Shariah committee may request for additional information which shall be duly provided by the management. In the event where the Shariah committee is not provided with the required information, the board shall be informed of the fact and appropriate action shall be taken to rectify the situation. Where appropriate, the board shall consider taking the necessary punitive measures against parties who intentionally fail to extend the required information.

Where the Shariah committee has reason to believe that the IFI has been carrying on non-Shariah compliant activities, the Shariah committee shall inform the board and to recommend suitable measures to rectify the situation. In cases where non-Shariah-compliant activities are not effectively or adequately addressed or no rectification measures are made by the IFI, the Shariah committee shall inform BNM of the fact.

All appointment including reappointment, resignation and removal of the Shariah committee members shall be made by the board, subject to the approval by BNM and the SAC. A member of the Shariah committee shall be a Muslim individual. The majority of members in the Shariah committee shall be a Muslim individual. The majority of members in the Shariah committee shall at least hold a university qualification in Shariah. The Shariah committee may comprise experts from relevant backgrounds such as finance and law, which could support the depth and breadth of the Shariah deliberations. The Shariah committee preferably shall comprise members of diverse backgrounds in terms of qualification, experience and knowledge. However, these members must not form the majority of Shariah committee.

It is interesting to note that the takaful board is encouraged to appoint at least one member of the Shariah committee as a member of the board who could serve as a ‘bridge’ between the board and the Shariah committee.

16.4 General Takaful Agents Registration Regulations (GTARR)

The rules for the registration and regulation of general takaful agents are enacted under the Third Schedule of the Inter-Takaful Agreement on General Takaful Business (ITAGTB). The rules, known as GTARR were formulated in consultation with BNM to provide the method of recruitment and supervision of intermediaries with the view to regulate, monitor and control the intermediaries’ professional conduct.

16.5 Islamic Financial Services Act 2013

Section 2	Interpretation
Section 5	Classification of, an construction of references to, takaful business
Section16	Licensed takaful operator to carry on family or general takaful business
Section 83	Appointment of actuary by licensed takaful operator
Section 90 -96	Takaful funds and shareholders’ fund
Section 119	Prohibition of payment out of takaful fund
Section 137	Approved takaful broker, approved Islamic financial adviser and approved issuer of designated Islamic payment instrument to establish customer account
Section 139 -142	Takaful issues
Section 212 -216	Provisions specific to takaful operators
Section 218	Priority of payments in winding up of licensed takaful operators

Section 285 Savings and transitional provision in respect of specific provisions of repealed Takaful Act 1984

Section 286 Conversion to single takaful business

Section 287 Licensed takaful operator which is private company to convert to public company

16.6 Fatwa in Islamic banking and takaful: Comparative study between Malaysia and GCC countries

Inconsistency in Shariah interpretation is one of the most pressing concerns in the Islamic financial industry and many parties have called for serious efforts to solve it. Standardization is one of the proposals. A comparative study was conducted by ISRA between fatwas issued by Shariah boards of the two main arenas of Islamic finance today, namely Malaysia and GCC countries to determine the seriousness of the inconsistencies.[1] Malaysia is represented by the Shariah Advisory Council of Bank Negara Malaysia (SAC BNM) while the GCC countries are represented by five fatwa-issuing bodies: (1) Dallah al-Barakah Bank (DAB), (2) Kuwait Finance House (KFH), (3) AAOIFI, (4) Majma' al-Fiqh al-Islami and (5) Dubai Islamic Bank (DIB). The most important finding of the study is that fatwas from both regions have more similarities than differences and that a clear difference is only evident in relation to certain Islamic principles.

[1]Mohamad Akram Laldin, Mohamed Fairooz Abdul Khir and Nusaibah Mohd Parid, "Fatwa in Islamic Banking: A comparative study between Malaysia and Gulf Cooperation Council (GCC) Countries", Research paper No.31/2012, International Shariah Research Academy for Islamic Finance