



**CRITICAL ANALYSIS OF FAMILY TAKAFUL  
OPERATIONAL MODELS IN MALAYSIA**

By:

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A dissertation submitted in fulfilment of requirement for  
Master of Science in Islamic Banking and Finance

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## ABSTRACT

Takaful and insurance have been compared long ago by many scholars around the world. Prior literatures of Takaful are mainly focusing on the concept and theoretical nature of takaful and its differences from insurance. Malaysian Takaful industry has been given flexibility in terms of the operational models adopted and to the researchers' knowledge; no research has been conducted in Malaysia regarding the choice of Takaful operational models by Takaful operators. It is important to study the motives behind choosing among different Takaful models since different models have different impacts on the Takaful funds, especially for Family Takaful funds. Therefore, this research is conducted to examine on reasons behind choosing Takaful operation models and to propose the most suitable model to be adopted by Takaful operators to be fair and equitable for both Takaful operators and participants. The representatives from Takaful operators are interviewed and it has been found out that most of Takaful operators prefer the Hybrid *wakÉlahMuËÉrabah* or Modified *wakÉlah* (principal-agent) model. The main reason is that Central Bank of Malaysia clearly sets the rule that in the *wakÉlah* contract, Takaful operators can charge *wakÉlah* fess (agent fees and administrative expenses) upfront to the participants (certificate holders). Moreover, an upper limit *wakÉlah* fees is 40% and hence, it is favourable to Takaful operators. The *MuËÉrabah* (profit and loss sharing) model is not much favoured in the Malaysian Takaful industry. Interview results further find out that most of the practitioners also think that the *wakÉlah* fees imposed on the participants are too much and the Hybrid *wakÉlah/MuËÉrabah* Modified *wakÉlah* model has too many layers of charging profits from the funds and consequently, the currently adopted models are at the disadvantages of participants. Since this research provides a clear picture of the current practice of the Family Takaful operating models adopted by the Malaysian Takaful operators, these findings will be useful for regulators and *SharÉÑah* advisors to look into this issue again to be fair and justice to involved parties

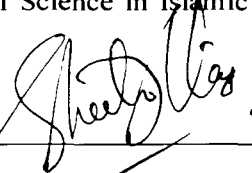
## ملخص البحث

لقد قام عديد من العلماء بالمقارنة بين التكافل والتأمين قبل زمن طويل في شتى بقاع العالم. والكتابات التي صدرت على هذا الموضوع أكثرها تركز على مفهوم ونظرية التكافل وعلى الفروقيين التكافل والتأمين. وهذه حقيقة إن شركات التكافل الماليزية قد تتمتع بمرونة بالغة من حيث نماذج تشغيلية. وحسب ما يجده الباحث، أنه لم يبحث أحد عن أسباب اختيار مدراء شركات التكافل، نماذج التكافل التشغيلية في ماليزيا. فلذا، إن البحث عن وجوه اختيار هذه النماذج التشغيلية لن يخلو من أهمية؛ لأنها تختلف بعضها عن بعض، ولها تأثيرات مختلفة في توزيع الفائض من أموال التكافل، خصوصا من أموال التكافل العائلي. ولذلك، هذا البحث يقوم بدراسة وكشف الأسباب لاختيار تلك النماذج في ماليزيا. وفي نفس الوقت، هذا البحث سيقترح أنسب وأحسن النماذج لكلا من شركات التكافل، والمشاركين فيها من حيث مبدأ العدالة. إن المقابلات التي أجريت مع وكلاء شركات التكافل، كشفت عن أن معظم الشركات تفض نموذج الوكالة المبنية على المراجعة أو الوكالة الجديدة.

وسببه الرئيسي هو أن البنك المركزي الماليزي وضع قوانين تسمح لمدراء التكافل المبنى على الوكالة أخذ رسوم الوكالة (التي تحتوى رسوم الوكيل ومصروفات المكاتب) من المشاركين مقدماً. وإضافة إلى ذلك، وضع الحد الأعلى لرسوم الوكالة هو 40%. وأما نموذج المضاربة بقى غير مفضلة لدى شركات التكافل لأنها تعتمد على توزيع الالفائض لأنه يحدد في مطالبة الأرباح من الأداء الفعلي للربح الذي يكون في نهاية العام أو نهاية فترة المضاربة. أيضاً، أفادت هذه المقابلات أن كثيراً من المهنيين يعتقدون أن رسوم الوكالة المطلوبة أكثر بكثير. هذا البحث يقدم صورة واضحة عن الممارسة الحالية للنماذج التشغيلية لتكافل العائلي التي تعتمد عليها شركات التكافل في ماليزيا. فهذا البحث يكو مفيداً للإداريين ومستشاري الشريعة لينظروا إلى هذه القضية مرة ثانية لتحقيق العدالة بين كل من الأطراف المعنية.

## APPROVAL PAGE

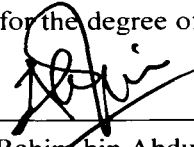
I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science in Islamic Banking and Finance.



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Sheila Nu Nu Htay  
Supervisor

This research paper was submitted to the IIUM Institute of Islamic Banking and Finance and is accepted as a fulfillment of the requirement for the degree of Master of Science in Islamic Banking and Finance.



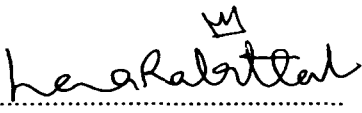
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Dean of IIUM Institute of Islamic  
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## DECLARATION

I hereby declare that this research paper is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Hanna Rabittah Bt Zaharin

Signature. .....

Date. 15/06/2012.....

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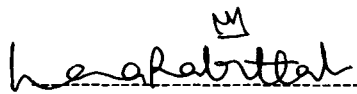
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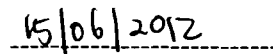
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# CHAPTER 1

## INTRODUCTION

### 1.1 BACKGROUND OF STUDY

Takaful has emerged as an important financial system with worldwide acceptance, as it provides for mutual assistance to participants in case of misfortune. Takaful Act 1984 defines takaful 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 the purpose*”. The conventional insurance concepts and practices are non-*islamic* due to its inherent *haram* elements, namely, interest, uncertainty and gambling. Hence, the emergence of Takaful overcomes the inherent *haram* elements in the insurance practices all over the world.

The benefits provided by Takaful to its participants are in line with Shari'ah and at the same time it fulfils the protection needs of the individual, group and business entity. According to Engku Rabiah, Hassan Scott, & Azman Ismail (2008), the concept of Takaful can be seen in the practice of '*Aqilah* (payment of blood money or Diyyah) under the Arab tribal custom. Then, this concept was adapted by Islamic practitioners through the verdict of the Prophet (*p.b.u.h*). It can be summarized that Takaful is the practice to help one another with good intention with the hope of getting *Barakah* (blessings) from Allah the Almighty at the same time.

The first Takaful Company in Malaysia was incorporated in 1985 and it was established under the Takaful Act 1984. Thus, it can be said that the local Takaful industry has been around for 25 years (Ahmad, 2009). The same author further states

that the insurance industry started about 100 years back which makes the Takaful industry relatively young compared to the insurance industry. The Takaful report of Bank Negara Malaysia (2006) states that the market penetration of the Takaful industry rose to 5.6% in 2005 from 5.1% in the previous year and the total assets of the Takaful industry increased by 16.9% to RM5.9 billion in 2005 (2004: RM5 billion), accounting for 5.7% (2004: 5.6%) of the total assets in the insurance sector. These show that the development of Islamic insurance or Takaful in Malaysia is a toddler compared to conventional insurance. The long established conventional insurance makes it essential for Takaful to be sufficiently innovative in order to satisfy the needs of sophisticated customers and to sustain its competitiveness and survivability.

If worldwide development of Takaful industry is considered, the total amount of contribution has gradually increased from US\$3.0 billion in year 2007 to US\$8.9 billion in year 2010 based on the World Takaful Report 2010 by Ernst and Young. The report indicates that the Takaful industry is growing worldwide and this is supported by the speech of Deputy Governor Bank Negara Malaysia in his keynotes Opening Address at the 3<sup>rd</sup> International Convention on Takaful and Retakaful (2007) stating that the growth rates of Takaful market for the past few years have been growing at around 20 percent.

Since the Takaful Industry is undergoing a period of rapid growth, it is not surprising that many issues on Takaful are still in conundrum. According to Ismail Mahbob (2009) the source of the problems is due to the deeply rooted conventional mind set among the practitioners, the scarcity of human capital with good blend of knowledge or qualification in Islamic finance and conventional insurance, the

awareness of the stakeholders, including Takaful operators. different *Shari'ah* opinions and flexibility of governing rules and regulations for Takaful operators.

Among the issues in the Takaful literature is the adoption of different models for different takaful products offered by the same Takaful operators (Salim, 2009). Tobias Frenz (2009) mentions that current contracts involved in the Takaful models can generally be categorized into six, namely; *Mudarabah*, *Musyarakah*, *Wadi'ah Yad Dhamanah*, *Wakalah*, *Waqf* and *Ju'alah*. He further elaborates that *Wakalah* and *Mudarabah* are the only two models that have been implemented so far especially in Malaysia. This view is also supported by Engku Rabiah, et al. (2008) whereby the models in practice are either *Wakalah* or *Mudarabah* or a combination of those two contracts. All these contracts can be applied in both the General Takaful and Family Takaful.

*Shari'ah* is as a source of general guidelines; its principles give a lot of space to the Takaful operators to exercise a variety of operating models. The operating models for distributing the surplus are quite comprehensive as long as the Takaful operators fulfil certain fundamental components that do not contradict the governing *Shari'ah* principles (Bank Negara Malaysia, Concept Paper: Guidelines on Takaful Operational Framework). As a result, a few models have been employed by the Takaful operators for different types of Takaful products offered by the same Takaful operators. It seems that Takaful operators are trying to offer the best model for each product that will make them competitive with insurance companies and profitable like insurance companies.

Although *Shari'ah* and Bank Negara Malaysia give flexibility for the Takaful operators to choose the preferred models, the unfortunate consequences have an effect on the surplus distribution. There exists incongruity about the practice of Family

Takaful surplus distribution in the worldwide Takaful industry. The surplus distribution has become a topic for debate among the regulators, experts, and Shari'ah Advisors as to whom it is entitled to it (Salim Ali, 2010). To the researcher's knowledge, there is a shortage of research in Takaful area, especially with regards to the determinants in choosing the models and their impacts on the surplus distributions in the Family Takaful products. The primary objective of this study is to propose the most suitable operational model for the Malaysian Takaful companies to manage its Family Takaful Fund. The secondary objectives are (a) to examine the motives of the Malaysian Takaful companies in choosing a particular model for its Family Takaful Fund, (b) to know the impact of each model adopted by the Malaysian Takaful companies in managing its Family Takaful Fund and (c) to analyze whether there is a need for a standardization of the operational models for the Malaysian Takaful companies to manage its Family Takaful Fund. These objectives have led to the following research questions:

Primary Research Question	a. What is the most suitable operation model for the Malaysian Takaful companies to manage their Family Takaful?
Secondary Research Question	b. What are the justifications of the Malaysian Takaful companies to choose that particular operation model for their Family Takaful?
	c. How these Family Takaful operation models affect the Malaysian Takaful companies?

	d. Should there be a uniformity of the operation models for the Malaysian Takaful companies to manage their Family Takaful?
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## 1.2 MOTIVATION AND SIGNIFICANCE OF STUDY

Takaful industry has become phenomenal because it is said to be an alternative to the insurance, considering the latter does not comply with *Shari'ah* principles in terms of the interest, uncertainty and gambling elements in its operations. Compared to insurance, the Malaysian Takaful industry is relatively new and there is not much study that has been done in this particular area of Takaful. It is also observed that the Malaysian Takaful industry has been given flexibility in terms of the operational models applied. Bank Negara Malaysia has no objection towards any of the operational models and gives options to the Takaful Operators to choose their own operational models where they see relevant. For this reason, it is interesting to examine what are the reasons behind the selected model. Therefore, the researcher feels that it is necessary to conduct an investigation of the current practice and to propose the most suitable method to be adopted by Takaful Operators in Malaysia.

## 1.3 SCOPE AND RESEARCH METHOD

Each of the Family Takaful operating models is examined theoretically in order to comprehend the strength and limitation of the implemented operating models. The study examines the motivating factors that influence the Takaful Operators to adopt that particular operating model for its Family Takaful Fund. The practitioners' view and judgment on the impacts of the selected operational models are deliberately

screened and analysed. The researcher has chosen to use the qualitative method as an approach to answer the research objectives. Basically, all the data are collected by interviewing the Takaful experts and practitioners. The researcher has adopted the interview method because it is the most relevant tool to the study. These data are then transcribed and analysed. The researcher also relies on both the primary and the secondary data to meet up the research objectives. The primary data is collected by interviewing the Takaful Operators. Secondary data collected by the researcher are mostly from the published journals, company documents, and subject relevant literature.

#### **1.4 STRUCTURE OF THE RESEARCH PAPER**

There are five chapters all together in this research paper. **Chapter 1** is the introductory part and this of course is followed by Chapter 2.

In **Chapter 2**, the researcher discusses the Takaful industry in Malaysian and the theoretical concept of surplus distribution models of the Family Takaful Fund. The meaning and basic concept are explained thoroughly by analysing the available secondary data such as the previous theses or documents relating to the matter of interest.

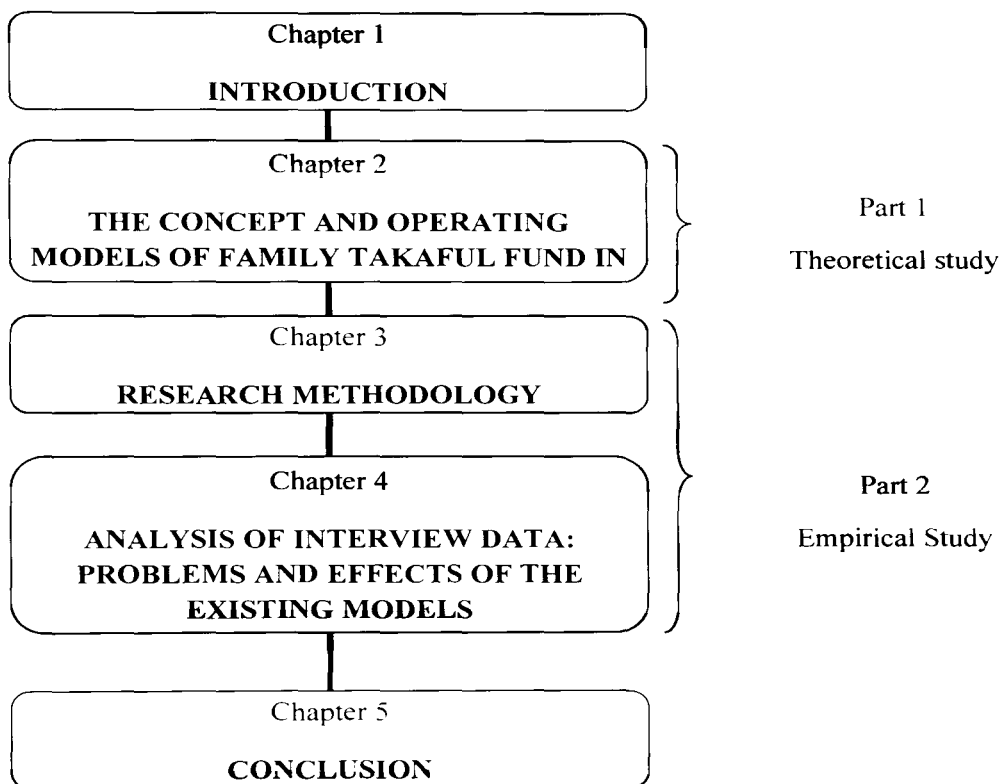
**Chapter 3** presents the research methods and design for this study. In particular, the researcher explains about the research approach, selection of data collection methods, design of research instruments, and sampling strategies.

**Chapter 4** is on the existing Family Takaful surplus distribution models in Malaysia. This chapter focuses on mode of Family Takaful surplus distribution models adopted by the Malaysian Takaful companies. It puts forward the results of the qualitative analysis of the semi structured interviews in respect of implementation of Family

Takaful surplus distribution models in the Malaysian Takaful industry. Other than that, it also discusses the problems regarding the adopted models. Any direct or indirect effects arising from the Family Takaful surplus distribution models will also be presented in this chapter.

**Chapter 5** summarises the findings, makes recommendations and concludes the study.

Figure 1.1: Structure of the Research Paper



## **CHAPTER 2**

### **THE CONCEPT AND OPERATIONAL MECHANISM OF FAMILY TAKAFUL IN MALAYSIA**

#### **2.1 INTRODUCTION**

Chapter 2 is divided into six sections. The second section discusses the Malaysian Takaful industry. Under this section, the growth, market penetration and the development of the Takaful industry in Malaysia are discussed to envision the current Malaysian Takaful situation. The third section gives explanation regarding the basic structure of the Takaful. This section further explains the definition and meaning of Takaful and the relationship between the Takaful Operators and the participants. This section also highlights the descriptions and concept of the contracts involved in the operations of the Takaful fund. Fourth section captures the different Takaful products available in the market. Fifth section covers the operating models of Family Takaful available in the market. The last section concludes the whole chapter.

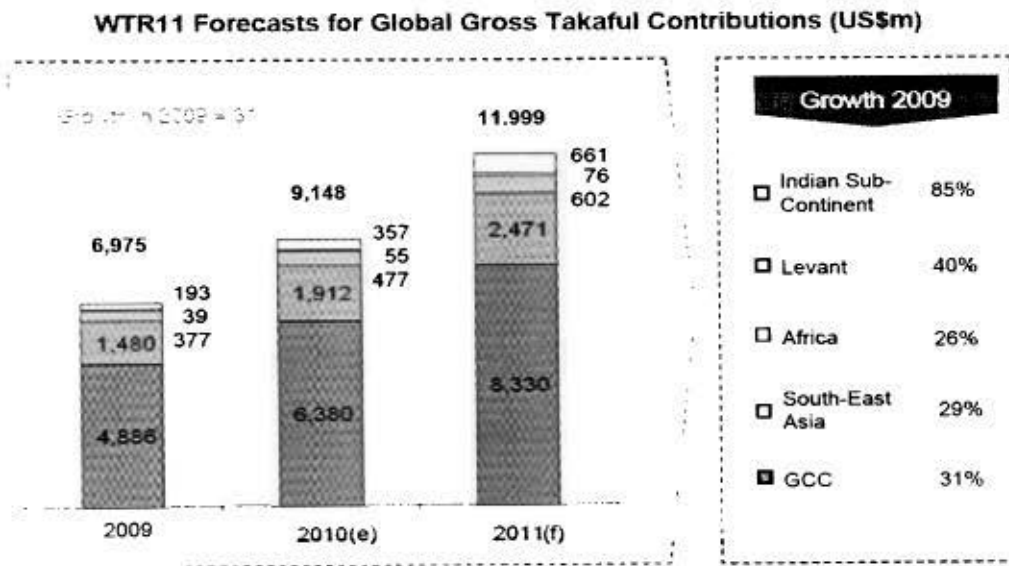
#### **2.2 Background of the Development of Takaful Industry**

Development of Takaful industry is explained in two sections altogether. The first section presents its development worldwide and the second section highlights its background in Malaysia. It is important to explain the historical development of Takaful industry because there are lots of points that can be learned from the history of Takaful.

##### ***2.2.1 Historical Development of Takaful Industry Worldwide***

The primary key message by Ernst and Young (2010) in its World Takaful Report is that the global Takaful market experience a continued growth in the previous years (refer to Figure 2.1). It has been reported that the compounded annual growth rate (CAGR) in 2009 for the global gross Takaful contributions has improved about 31%. The Indian sub-continent represents the highest growth of 85% in its Takaful contributions, followed by Levant of 40%, Africa of 26%, South-East Asia of 29% and GCC of 31%.

Figure 2.1  
Global Gross Takaful Contributions (US\$ Million)

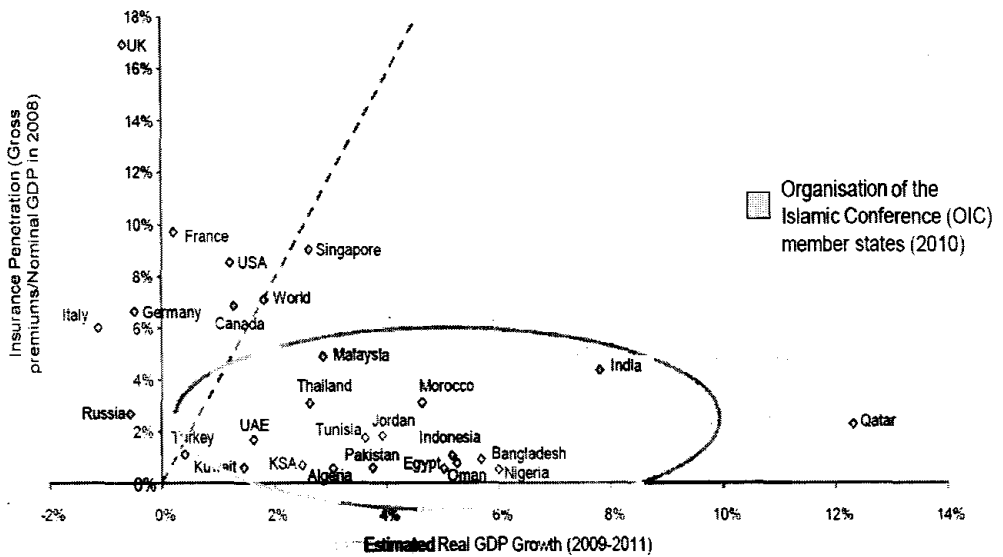


Source: Ernst and Young, World Takaful Report (2011), pp. 14

This shows that the Takaful industry from 2005 until 2009 has experienced a significant growth and is making its way into the global market. The growing gross Takaful contributions in the global industry is due to the facts that more Muslim

people all over the world have grasped the concept of Takaful in the recent years and that there is an increased awareness with regard to Takaful among them (Macey, 2008). Maysami and Kwon (1999) claim that Takaful is growing fast in the Islamic countries with Muslim population but it is also found in North America, Australia and selected European countries.

Figure 2.2  
Insurance Penetration and Real GDP Growth for Selected Countries (2009-2011)



Source: Ernst and Young, World Takaful Report (2010), pp. 40

The circled area in Figure 2.2 shows that the overall insurance penetration in the Organisation of Islamic Conference (OIC) countries remains sluggish compared to the estimated real GDP growth. Although the Takaful industry experiences a continued growth but penetration remains low in the key markets (OIC countries). The

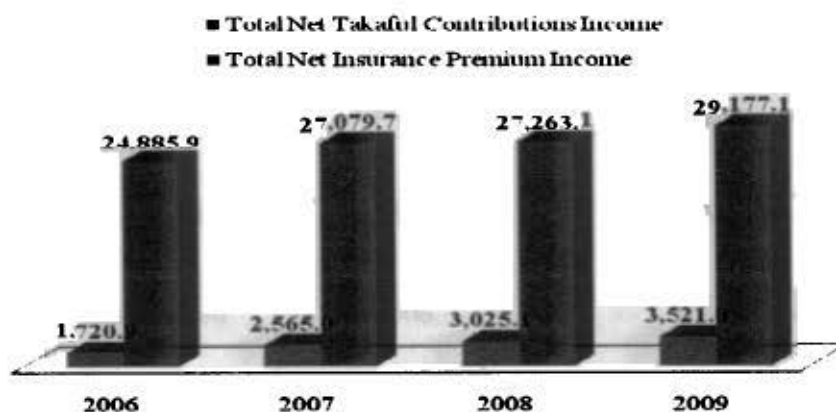
circumstance is caused by the small number of Takaful Operators in the regions and the great regulatory challenges facing the Islamic finance industry nowadays such as the absence of a regulatory body that operates in accordance to Islamic principles (Sameer Abdi, 2007).

Basically, the world is experiencing a healthy and growing Takaful industry. Islamic Development Bank (IDB) in Jeddah promotes Takaful through its education department while Saudi Arabian Monetary Agency (SAMA) provides regulations for the insurance products in the Kingdom of Saudi Arabia (Dawood Yousef Taylor, 2005). The modern day Takaful claims to have its first appearance in Sudan in 1979 and has been making its way throughout the world since then (Maysami & Kwon, 1999; Islamic Fiqh Academy, 2000; Dawood Yousef Taylor, 2005; Wahab, Lewis and Hassan, 2007; and Farooq, Chaudhry, Alam & Ahmad, 2010). The main reason why Takaful was reintroduced in 1979 is because Muslim scholars realized that the conventional insurance did not fulfil the Muslim ethics (Maysami & Kwon, 1999; Islamic Fiqh Academy, 2000; Dawood Yousef Taylor, 2006; Wahab, Lewis and Hassan, 2007; and Farooq, Chaudhry, Alam & Ahmad, 2010). They conceded that conventional insurance is deemed *Fasid* because the contracts involve *Gharar*, *Maysir* and the investments of premiums are *Riba*-based. However, Yusof Al Qaradawi (1985) believes that the modern form and concept of insurance is acceptable and only opposes the means and methods of the conventional insurance. In his view, insurance is acceptable if it is modified in a way that conforms to the Islamic principles. Tan Kin Lian (2006) summarizes that Takaful has been revolutionizing because the industry has been receiving support and approval from the *Shari'ah* scholars around the world.

### 2.2.2 Historical Development of Takaful Industry in Malaysia

Malaysia has the highest insurance penetration of 5% relative to its real GDP growth of 3% compared with other OIC countries in the circled area. Given the vast potential for further enhancement of the insurance or Takaful penetration rate in Malaysia, there are tremendous growth opportunities for the insurance and Takaful industry in supporting the requirements of the economy.

Figure 2.3  
Total Net Takaful Contribution Income  
Vs Total Net Insurance Premium Income (RM Million)



Source: Annual Takaful Statistics, Bank Negara Malaysia (2009)

In Malaysia, the total net contribution income each year for Takaful shows an increasing pattern since 2006. The thriving performance of the Takaful industry remained constant until 2009 amidst the rising challenges and the Takaful contribution continues growing each year underpins by the strong growth in the domestic economy. The total net growth of Takaful contributions increases greatly by 49% in 2007 but in 2008, the total net growth of Takaful contribution decreases to 17.9%, and it went further down in 2009 to 16.4%. The Takaful industry is in strong position to

further in an environment of stronger economic growth and more favourable Islamic business environment in Malaysia (Dawood Yousef Taylor, 2005). Figure 2.4 exhibits the same number of Takaful Operators in Malaysia from 2006 to 2009. Although the number of Takaful players in Malaysia has been constant since 2006 but the Takaful market in Malaysia has grown since 1985 from only one Takaful Operator to eight Takaful Operators in 2009.

Figure 2.4  
No. of Registered Takaful Operators in Malaysia

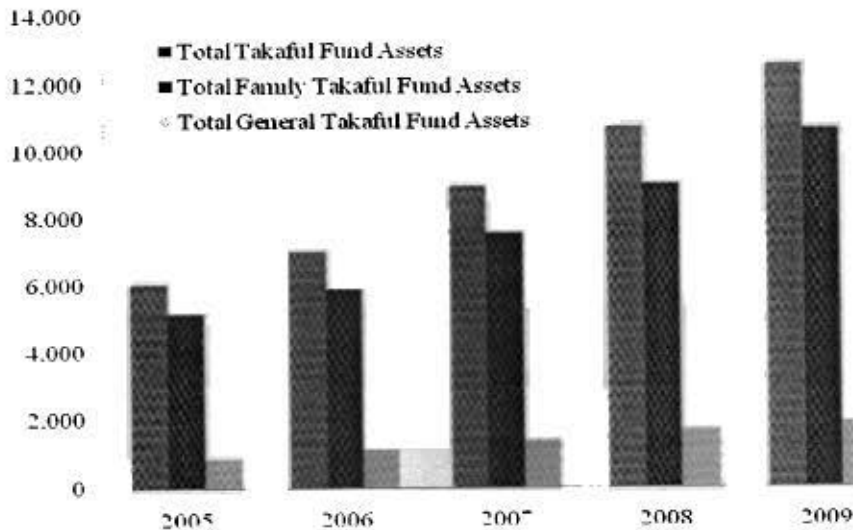
	<b>Takaful Operator In Malaysia</b>	<b>Year of Incorporation</b>	<b>Operational Mechanism Used for Family Takaful Product</b>
1	Syarikat Takaful Malaysia Berhad	1985	Mudarabah
2	Takaful Ikhlas Sdn Bhd	2003	Wakalah
3	MAA Takaful Berhad	2006	Wakalah
4	HSBC Amanah Takaful Malaysia Sdn Bhd	2006	Wakalah
5	Prudential BSN Malaysia Berhad	2006	Wakalah
6	Hong Leong Tokio Marine Takaful Berhad	2006	Wakalah
7	CIMB Aviva Takaful Berhad	2006	Wakalah
8	Etiqa Takaful Sdn Bhd	2007	Wakalah

Source: Annual Takaful Statistics, Bank Negara Malaysia (2009)

However in September 2010, Malaysia's Minister of Finance has approved the issuance of the four family Takaful licences pursuant to the Takaful Act 1984 to the following joint ventures:

- 1) American International Assurance Berhad (70%) and Alliance Bank Malaysia Berhad (30%);
- 2) AMMB Holdings Berhad (70%) and Friends Provident Group plc, UK (30%)
- 3) ING Management Holdings (Malaysia) Sdn Bhd (60%), Public Bank Berhad (20%) and Public Islamic Bank Berhad (20%); and
- 4) The Great Eastern Life Assurance Company Limited (70%) and Koperasi Angkatan Tentera Malaysia Berhad (30%);

**Figure 2.5**  
Total Takaful Fund Assets Vs Total Family Takaful Fund Assets and Total General Takaful Fund Assets (RM Million)



Source: Annual Takaful Statistics, Bank Negara Malaysia (2009)