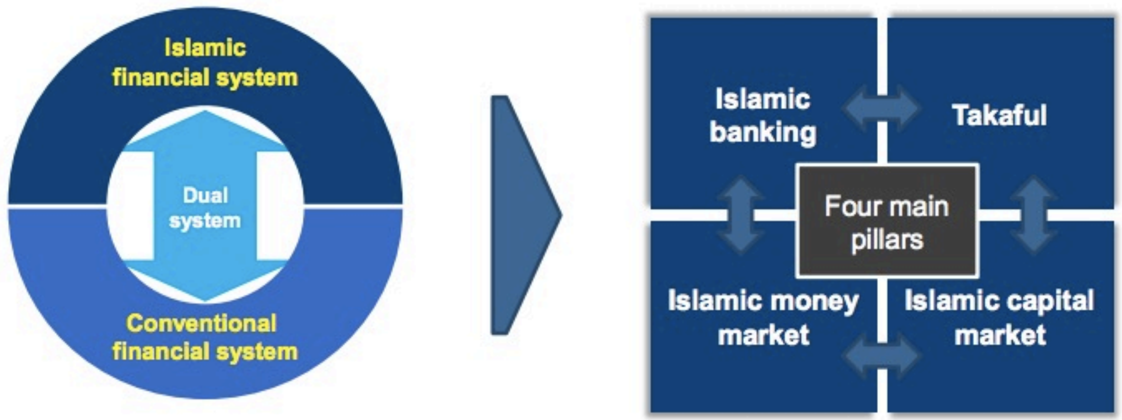

Takaful Practices
zulkiflihasan.com

Takaful in Malaysia developed as component of comprehensive Islamic financial system operating in parallel with conventional financial system



Dual Financial System

The mandate for developing dual financial system explicitly codified in Central Bank of Malaysia Act 2009

Comprehensive Islamic Financial System

- Ensure sustained industry viability via optimised synergies from interlinkages
- Underpinned by :
  - Strong & diversified players
  - Wide range of products & vibrant financial market

Family Takaful

Ordinary family or Individual family takaful (individuals) – Education, mortgage, health and riders. Financial benefits arising from death or permanent disability, as well as long-term savings (investment), and investment profits that are distributed upon claim, maturity or early surrender.

Group family takaful (employers, clubs, associations and societies) – Group education, group medical, health and riders. A minimum number of participants are required to qualify under these plans. Protection in the form of financial benefits arising from death or permanent disability. • Annuity – a plan that provides regular income upon your retirement.

Investment-linked – A portion of your contribution is used to buy investment units, such as units in equity or fixed income securities. The takaful protection covers death and permanent disability.

General Takaful

- Protection of properties, business assets and any liabilities arising from loss or damage.
- Fire takaful
- Business takaful
- Motor Takaful

Takaful model

- Mudharabah: was developed in malaysia
- Wakalah: was developed in the gulf
- Waqf : was developed in south africa
- Hybrid
- New Model
  - Wadiah ya dhamanah
  - Musharakah Taawuniyah

Choice of Model

Shariah concerns

Regulatory concerns

Technical and business concerns

Takaful Business Models

Sudan, Egypt, Syria, KSA-Mudharabah

Malaysia and Middle Eastern TO-Wakalah hybrid

Indonesia, Pakistan Sri Lanka-Wakalah and Windows operations.

Mudharabah Model

TO as the entrepreneur will accept payment of the installments or contributions called *ra'sul mal,* from investors or provides of capital or fund, popularly known as takaful participants acting as *sahib-ul mal.* the takaful operators as the entrepreneur will accept payment of the installments or contributions called *ra'sul mal,* from investors or provides of capital or fund, popularly known as takaful participants acting as *sahib-ul mal.*

income to the operator as *mudharib* is calculated at the end of the contract under the *al-mudharabah* model

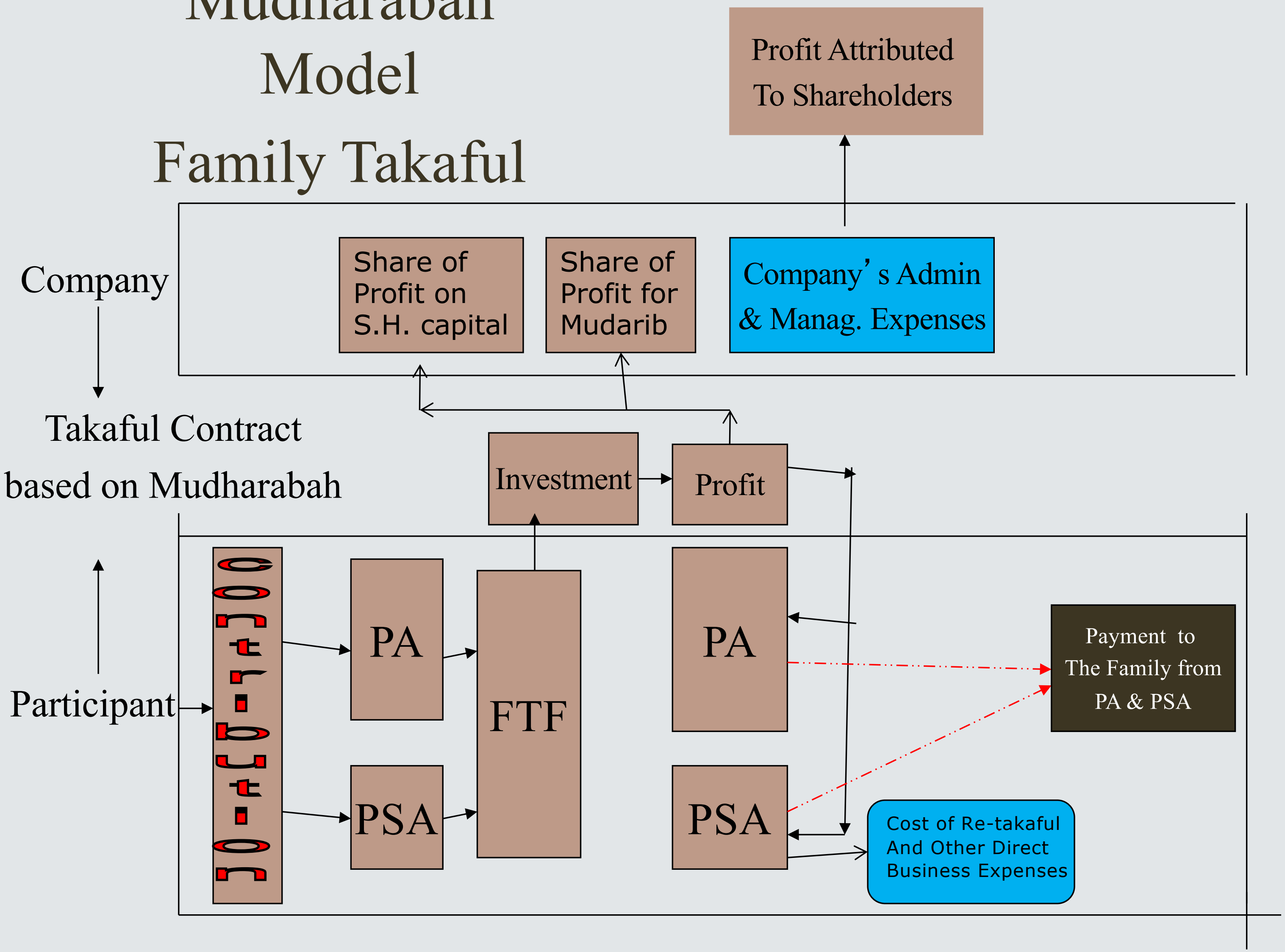
Family Takaful Business (mudharabah)

In Family Takaful each Takaful installment is divided and credited into two separate Accounts namely, the Participants' Account(PA) and the Participants' Special Account(PSA). A substantial proportion of the installments is credited into the PA solely for the purpose of savings and investment.

The balance of the installments is credited into the PSA as `tabarru' for takaful operator to pay the Takaful benefits to the heir(s) of any participant who may die before the maturity of the contract.

Mudharabah Model

Family Takaful



General Takaful Business

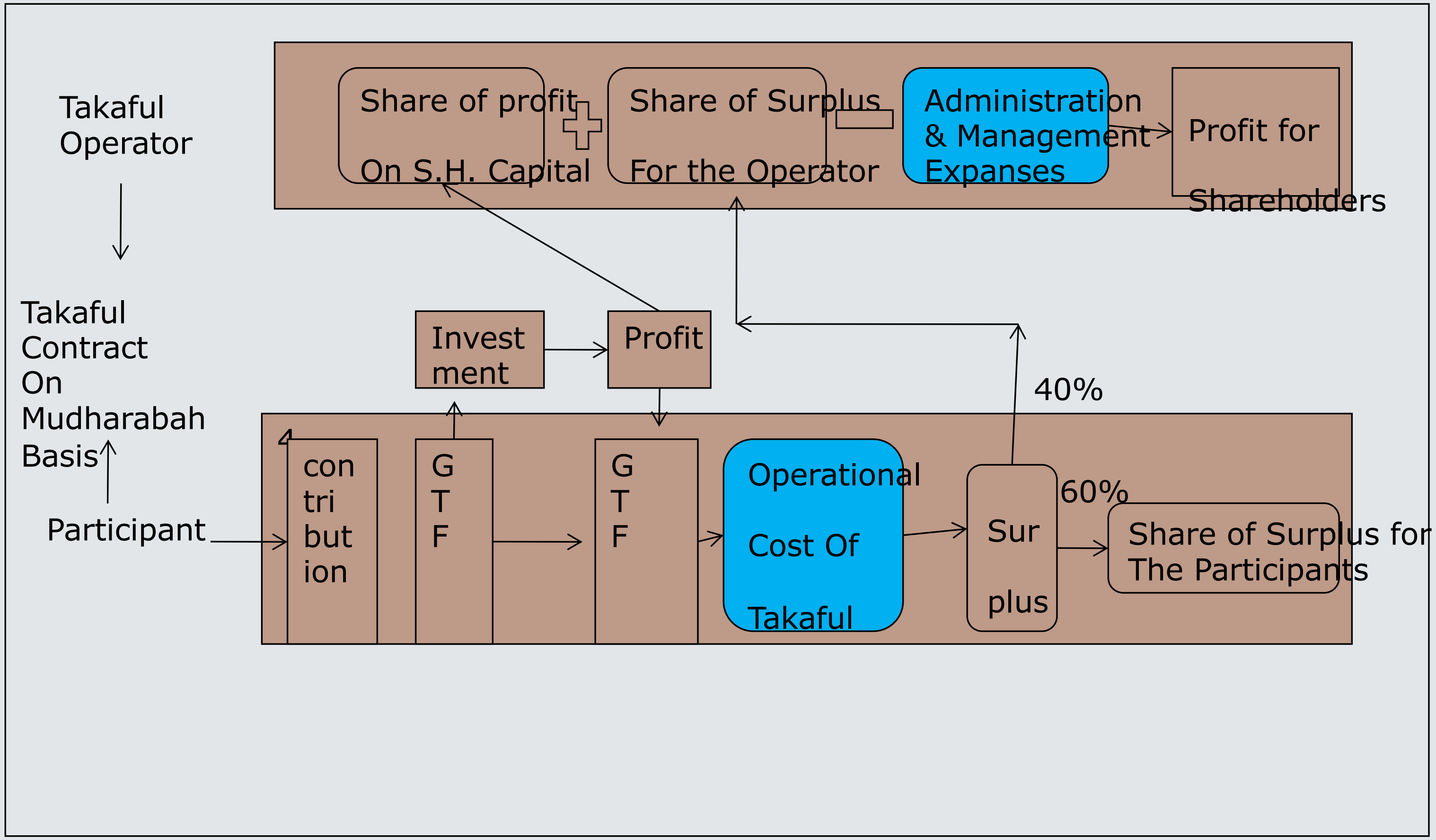
C buys Fire Takaful Policy. He pays the contribution for RM 1000 for a year. Takaful Operator invests the contribution paid by Mr. Ahmad in the investment company (Halal Investment Counter) according to principle of Al-Mudharabah. Takaful Operator get 10 % profit.

So at the end the Takaful Operator will get RM 1100 (Principle + Profit).

Then the amount of RM 1100 (In the General Takaful Fund) will be deducted for allowed cost such as Retakaful, Claims, and Reserves.

If there is a surplus (Profit) after deduction for allowed cost, then the sharing of surplus will be distributed to both Takaful Operator and Participant 60%: 40% respectively (Based on the agreement in the contract).

Mudharabah Model: General Takaful



Shariah Issues on Mudarabah Model

- Mudarabah is a commercial contract, hence not suitable for a donation (Tabarru) based scheme.
- Donation given by the participants can not become capital for Mudaraba at the same time.
- Distribution of surplus among the participants in proportion of their contributions is like a conditional gift(Hiba bis-Sawab) which is not allowed.
- Sharing of surplus in case of General Takaful (instead of profit) makes the contract essentially the same as conventional insurance contract.
- Provision of Qard Hasan from the Shareholders fund in case of deficit is not correct as Mudarib is not a guarantor.

Fees in Mudharabah Model

The SAC in 2006

"For takaful model based on mudarabah contract, takaful company is not allowed to charge any management fee on contribution paid by takaful participants. On the other hand, all operational expenses shall be borne by the shareholders' fund whereby its income is derived from its share of investment profits or surplus of the takaful fund" (SAC BNM, 2010, 77).

Investment and PRF

Investing PRF the tabarru fund may trigger potential Shariah and operational issues

The legality of investing the risk fund and the contract being used to invest the risk fund.

The donation must be used for the specified purpose or the designated recipients unless the donors later authorized for another purpose such as investment, either on their own initiative or in response to the agent's request.

Wakalah Model

A contract of agency in which a person delegates his business to another and substitutes the other in his place. The person delegated called wakil (agent) whose fundamental obligation is to provide his skill towards the betterment of assigned job. Thus, both the principal and the agent equally bound by each other under contract of al-wakalah.

The practice of al-wakalah allows the operator to charge fees as income upfront or at the point the contract is incepted.

Wakalah Model

1

Consists of contribution (I*shtirak*) by Participants (*mushtarik*) that includes payments of fees and charges and a portion for donation (*tabarru*) to a community takaful fund.

2

All risks are borne by the takaful fund and the annual operating results (Surplus/Loss) belong solely to the Participants. The takaful operator (*wakeel*) does not share directly in the risk, deficit or surplus.

3

Participants agree to pay specified direct expenses and to pay the takaful operator a set fee (*wakala* fees) to manage the operations on their behalf, which may include a performance fee as incentive that is charged to the surplus, if any.

4

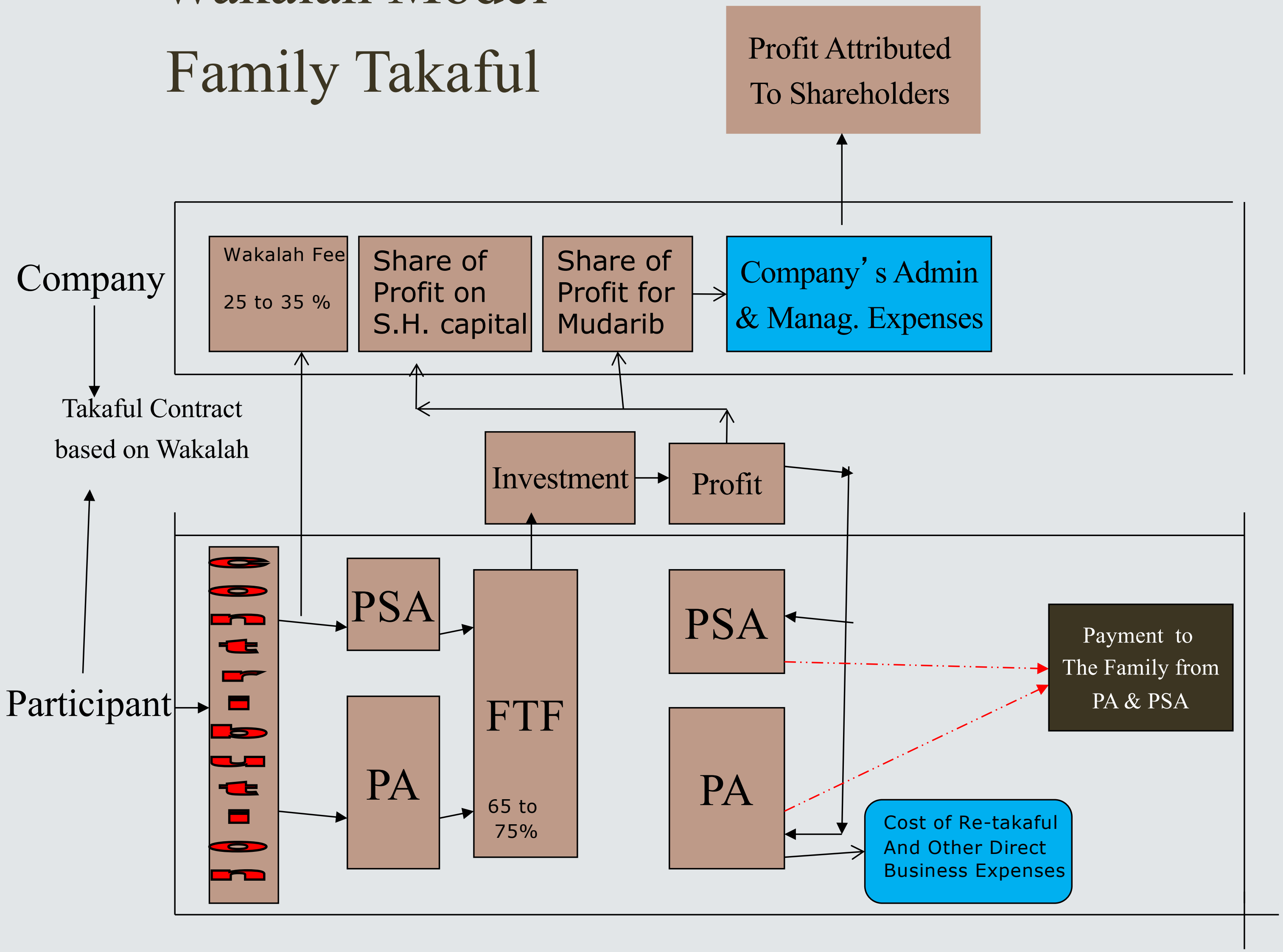
If the takaful Operator is to generate a profit from its efforts, it must manage the operations (including salaries, overhead, selling commissions, sales and marketing expenses, etc.) entirely within the disclosed *wakala* fees.

5

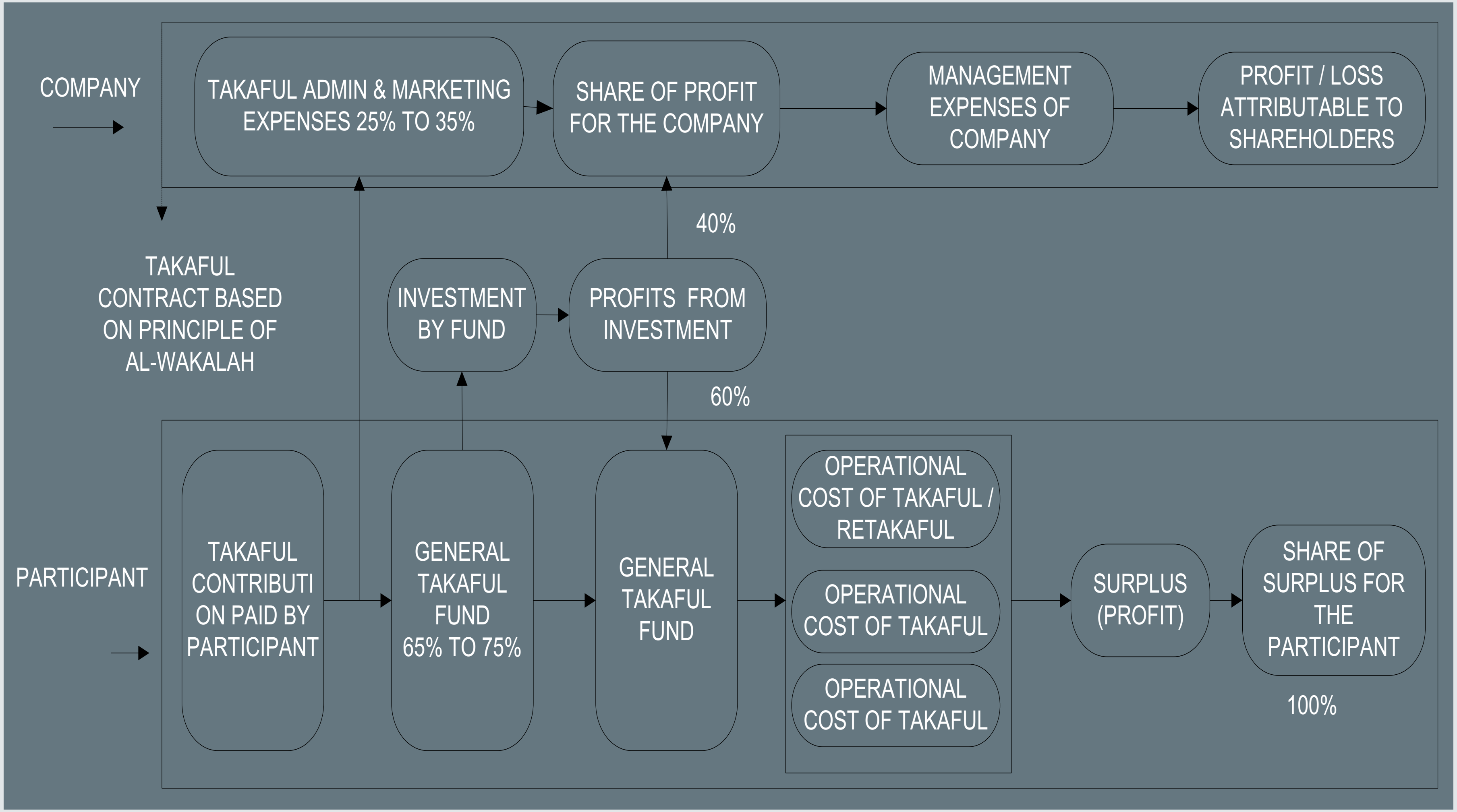
al-wakala model can be viewed as transparent as fees are clearly related to operator's operational costs.

Wakalah Model

Family Takaful



Wakalah Model General Takaful



Shariah Concerns regarding Wakalah Model

- Wakalah model is free from many objections raised against Mudaraba model
- Some Shariah concerns:
- Distribution of surplus among the participants in proportion of their contributions is like a conditional gift (Hiba bis-Sawab) which is not allowed.
- Provision of Qard Hasan from the Share holders fund in case of deficit is not correct as Wakil is not a guarantor.

Waqf Model

A Waqf Fund would basically be a separate legal entity to which the Shareholders would initially make a donation to establish the Waqf Fund.

The donation can be of any reasonable amount (Shariah Board may specify such an amount).

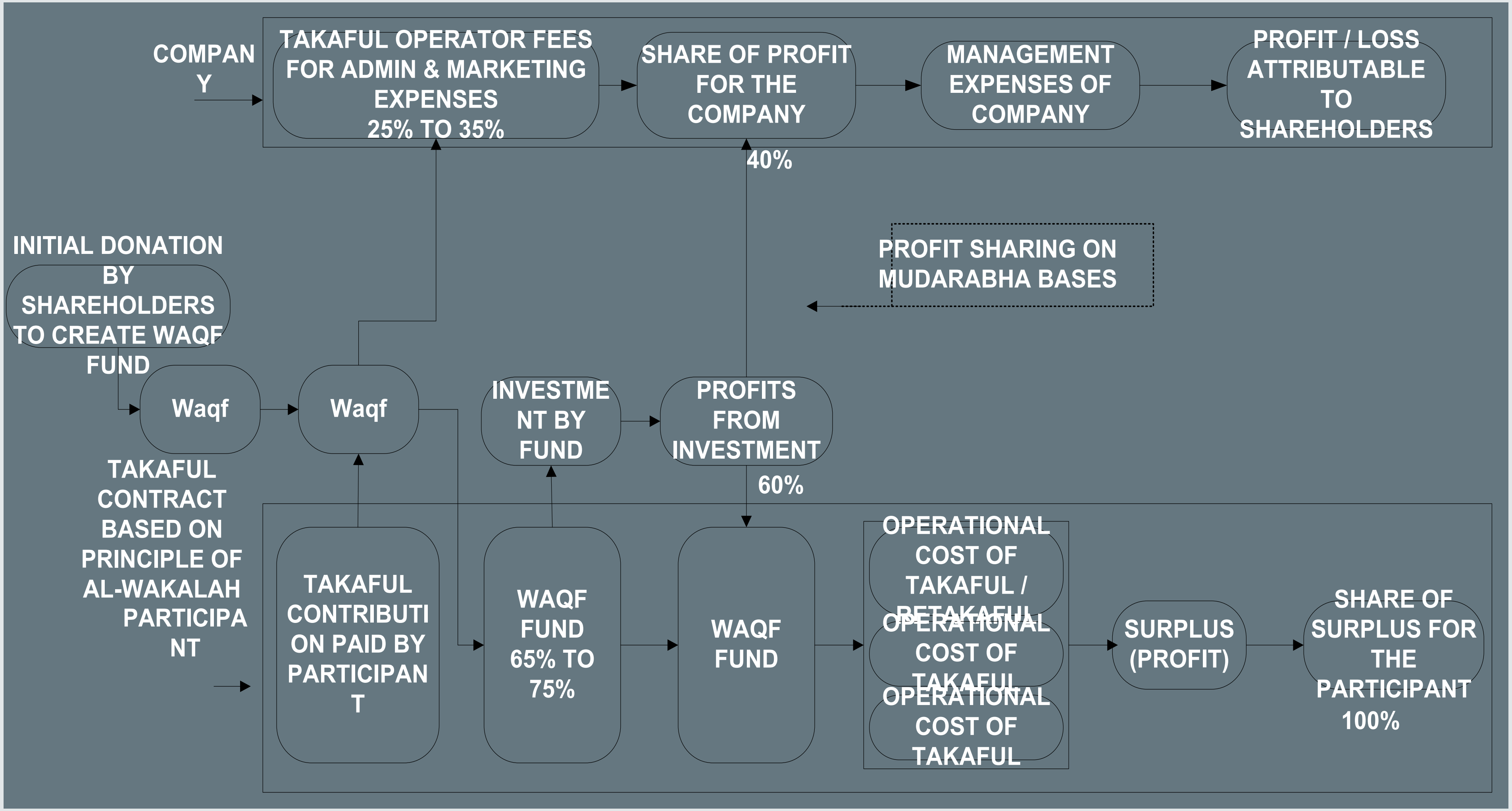
The objectives of the Waqf fund would be to provide relief to participants against defined losses as per the rules of the Waqf fund.

Waqf Model

The relationship of the participants and of the operator is directly with the Waqf fund. The Operator is the Wakil of the Waqf Fund and the participants pay one sided donation to the WAQF fund (not conditional) which also eliminates the issue of Gharar.

The WAQF fund rules may define the sharing of surplus and other rules under which it would operate but there is no obligation to distribute surplus. Further the Qard would be given by the shareholders to the WAQF entity and not to individuals as in the typical Wakalah model.

Waqf Model


COMPANY
TAKAFUL OPERATOR FEES FOR ADMIN & MARKETING EXPENSES 25% TO 35%
SHARE OF PROFIT FOR THE COMPANY
MANAGEMENT EXPENSES OF COMPANY
PROFIT / LOSS ATTRIBUTABLE TO SHAREHOLDERS
40%
PROFIT SHARING ON MUDARABHA BASES
INITIAL DONATION BY SHAREHOLDERS TO CREATE WAQF FUND
Waqf
Waqf
INVESTMENT BY FUND
PROFITS FROM INVESTMENT
60%
TAKAFUL CONTRACT BASED ON PRINCIPLE OF AL-WAKALAH
PARTICIPANT
TAKAFUL CONTRIBUTION PAID BY PARTICIPANT
WAQF FUND 65% TO 75%
WAQF FUND
OPERATIONAL COST OF TAKAFUL / RETAKAFUL
OPERATIONAL COST OF TAKAFUL
OPERATIONAL COST OF TAKAFUL
SURPLUS (PROFIT)
SHARE OF SURPLUS FOR THE PARTICIPANT 100%

Wakalah and Waqf

- The shareholders and participants make donation to establish waqf fund.
- Both sholders and participants would lose ownership rights on their contribution
- Waqf fund will be managed by the TO
- Agency fees are deducted from the waqf fund.
- The TO undertakes the role of investment agent (*wakalah bil istithmar*) when it invests the waqf fund and is entitled to a certain percentage of the investment profit as a performance fee.

Hybrid of Wakalah and Mudharabah

Underwriting activities: The TO is entitled to an agency fee for managing the fund as a wakil.

Investment activities: The TO is entitled to share of profit for managing the investment of the fund as mudarib.

Wadiah ya al-dhamanah

Custodian of the fund provides a total guarantee of the savings, while the ownership of the fund belongs entirely to the participants or depositors.

The participating fund is the mudharabah fund, as TOs share the profits of the investments of the fund, whilst the non-participating funds are the wadiah and the tabarru' funds as both provide the guaranteed benefits. The former is on the concept of qard, and the latter is on the concept of risk sharing.

The wadiah fund functions to provide the guaranteed survival benefits (non-forfeiture benefits), similar to conventional life insurance (guaranteed cash values that the insurance company guarantees will be owned by the policyholder as he continues to pay the premium.)

Musharakah Taawuniyah Model

- The participants will be the small equity holders joining together with the objective of helping one another in any hazardous situation.
- The participants will agree beforehand that they would have both risk and reward of the cooperative activity for mitigation of losses.
- Mutually agree beforehand that they would pay extra contribution in case the claims are more than the net revenues.
- Reserves to cover the possible losses in future but also to build-up capacity to sustain any voluminous losses in future.

Income Purification

Even though takaful is operated under Shariah principles, non-Shariah income may arise when a non-compliant business activity is inadvertently undertaken.

This commonly happens when the fund manager appointed by the TO invests in listed companies whose status changes, after a periodic review, to Shariah non-compliant. Non-Shariah income may arise when a takaful operator covers a risk that contains both Shariah-compliant and non-compliant elements.

Guaranteed Investment Scheme

Inability to offer minimum guaranteed returns as its conventional equivalent does.

Guaranteed investment return, cannot be mirrored in takaful.

As guaranteeing the investment return is not allowed in an investment contract such as mudarabah, the takaful industry currently uses indicative returns in describing what contributors might expect from the TO's investment strategy.

Takaful Coverage on Conventional Loan

Housing loans are riba based and providing takaful cover (eg. MRTT) as collateral can be considered as syubhah.

SAC allows takaful coverage for conventional loan

Is it permissible for ijarah financing to be covered by insurance?

SAC ruled that for the first year of ijarah financing, Islamic financial institutions (IFI) should ensure takaful be the first option for the coverage plan. IFIs are required to promote the subscription of takaful in the second year of financing and thereafter. Customers are given the flexibility to take up insurance under the following circumstances:

i. Takaful protection is not offered in particular sectors or classes;

ii. None of the available takaful operators approve the customer's application for takaful protection; or

iii. The cost of insurance coverage is significantly more competitive compared to takaful.

In the case where the insurance coverage is subscribed based on the above circumstances, the amount of insurance premium may be included in the total ijarah financing

RETAKAFUL

Risk spreading or transfer	Protection against catastrophic risks	Surplus stability
Capacity boosting	Services	Sources of profit

Types of Retakaful

Facultative-

- Proportional Facultative;
- Non-proportional Facultative

Treaty-

- Proportional Treaty: Quota Share and Surplus Treaty
- Non-proportional Treaty: Excess of Loss and Stop Loss

Only licensed professional retakaful operator can carry on both family takaful business and general takaful business

Issue on Non-proportional Retakaful

Some views it as Shariah-non compliance mainly due to absence of proportional relationship between sum insured, contribution and claim.

Others view it as Shariah compliance as long as properly designed and priced to ensure fairness between takaful fund and retakaful fund.

Profit Commission under Proportional Retakaful

Some views performance based payment such as profit commission to cedant as not Shariah compliance as it undermines the spirit of mutual assistance.

Others view it acceptable as long as fairly calculated

Inward Retakaful from Conventional Insurance and Outward Retakaful to Conventional Reinsurance

i. A takaful company is not allowed to accept inward retakaful whether on treaty or facultative basis from a conventional insurance company and reinsurance company; and

ii. A takaful company is given the flexibility to distribute its risks based on outward retakaful to conventional insurance company and reinsurance company subject to the following conditions:

a. Priority shall be given to a takaful company and retakaful company;

b. Non-existence of a takaful company and retakaful company, either locally or internationally, that is viewed as capable to absorb the distributed risks; and

c. The strength of the takaful company and retakaful company, either locally or internationally, is doubtful.

Reinsurance Cessation

AAOIFI Standard 41 and BNM's Circular on General Retakaful Arrangement:

The ceding should be done initially with retakaful operators at the maximum level.

Must be on short term basis and approved by the SC.

TO cannot take ceding or profit commission from reinsurance company.

Underwriting Conventional Insurance

AAOIFI allows with certain conditions:

The contract used must be retakaful and approved by the SC.

It is not a treaty arrangement.

The subject matter of insurable interest is not in conflict with Shariah.

Investment Challenges

- Sufficient investment opportunities?
- Sufficient Shariah compliant investment?
- Takaful investment returns lower than insurance company.
- Takaful fund is also taxed at 8%.
- Asset liability matching- long term liability v short term assets.

Challenges of Retakaful

- Limited underwriting capacity
- Lack of expertise
- Reinsurance expertise
- Retakaful needs to have greater financial strength and better talent.

Other Challenges

- Regulation changes
- Economic changes
- Talent
- Retakaful capacity
- Lack of Shariah compliant assets
- Globalisation