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ORIGINAL ARTICLE

The Management of *Takaful* Business Models in Malaysia

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ABSTRACT

Malaysia has pioneered the establishment of commercial takaful (tijari) companies since 1984 as opposed to the mutual or a pure co-operative form of takaful (ta`awuni) introduced from Sudan originally in 1979. Up until this point, the majority of takaful companies worldwide have chosen to run their operation using a tijari model rather than a mutual or pure co-operative type. This preference might be due to the difficulties and problems associated with running the mutual type as well as the promise of financial gains in operating the commercial model. Perhaps mutuality in contemporary Islamic insurance industry is merely superficial by its name (takaful) but not in essence. However, there are different business approaches or models to realizing this vision, of which at least three are implemented by takaful operators worldwide, namely: profit-sharing (mudarabah), agency model (wakalah) and hybrid model. In the field of Malaysian Islamic insurance, modified versions of mudarabah and wakalah models are implemented although the latter model seems to be favored by most takaful operators. It argues that since there are different models and principles adopted within the takaful operation (resulting from its 'commercialization'), this variation in itself gives rise to many Shari`ah issues and disagreement among scholars now noted. This preliminary study therefore sets out to highlight these issues for further research.

Key words: Takaful, Management, Business, Commercial, Malaysia

Introduction

After nearly three decades since the first Islamic insurance (*Takaful*) was introduced in Sudan in 1979, the concept of *takaful* seems to have gained wider acceptance and continues to develop. Thus, hundreds of *takaful* operators now offer their complete range of products in more than 22 countries. Indeed, a recent estimation of the global *takaful* market shows that it might achieve US12.5 billion of premiums by 2015. This figure is a revision from an earlier similar estimate of US7.5 billion forecasted by market analysts in 1999. Several factors may have contributed to this faster growth rate, which include increasing awareness amongst the Muslims of the *Shari`ah*-compliant risk management options and of continuous effort made by *takaful* operators to enhance their product coverage and distribution channels. Despite the tremendous development of the *takaful* sector, a considerable number of issues (i.e. technical and *Shari`ah*) remain unsolved amongst operators. The most basic issue (and probably the most contentious) is the choosing of appropriate *takaful* business models. This matter has caused a certain amount of division within the *takaful* business community and might weaken the whole industry if it is not addressed properly.

Takaful Models : Between Co-Operative And Commercial-Centred:

The issue of whether Islamic insurance providers should be organized as mutual/co-operative (*ta`awuni*) or commercial (*tijari*) companies has been debated extensively by Islamic scholars. Since a commercial insurance contract is deemed to be null and void by a majority of the *fuqaha*', it is well understood why a mutual or a co-operative form of *takaful* company is highly recommended by them as an alternative to the conventional insurance. However, from the practitioner's perspective the originally proposed structure of *takaful* entity

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appears to be unfeasible since it requires the whole scheme to be managed by the participants alone, without any involvement from outside shareholders.. Furthermore, such organization has a typical or perhaps major drawback which it can only obtain resources for its members and cannot raise equity capital for further expansion.

As a result, almost all *takaful* operators worldwide has resorted to shareholder-based or commercial entity instead of pure co-operative or mutual organization. Still, the co-operative characteristic of Islamic insurance may be preserved in the business since there will be an eventual redistribution of surpluses to the participants. Indeed, this feature may render commercially *Takaful* acceptable under Islamic jurisprudence and distinguish it with commercial insurance. Interestingly, some scholars maintain that this arrangement (i.e. applying surplus distribution to a joint-stock company) represents the co-operative *takaful* model, even though it will mislead the established meaning of a co-operative entity. Thus, it is perhaps more accurate to classify this structure as a commercial *takaful* rather than co-operative.

In general, there are two basic models for commercial *takaful*, namely: profit-sharing (*mudarabah*) and agency models (*wakalah*). However, there are several variations of both models which usually termed as either 'modified' or 'hybrid' models by practitioners. Modified models usually involve the adjustment of some conditions stipulated under *mudarabah* and *wakalah* principles. For example, under the modified *mudarabah* model, instead of sharing direct investment profits, the participants and the *takaful* operator will share 'underwriting surpluses'. Whereas the hybrid models normally involve the mixture of two or more Islamic principles or models. For example in Pakistan, the *wakalah* with *waqf* model has been introduced, whereby a separate legal entity of *waqf* has been established to mediate between the participants and the operator. In brief, participants contribute a 'one-sided donation' to the *waqf* fund, which in turn is managed by the *takaful* operator under the principle of *wakalah*. In summary, each basic commercial *takaful* model (either *mudarabah* or *wakalah*) could be further classified either as a pure, modified or hybrid model.

Commercial Takaful Models in Malaysia:

In the field of Malaysian Islamic insurance, its uniqueness lies in the freedom for each company (which is currently eight providers) to adopt whichever operative model is appropriate for them, provided that this model complies with the principles of Islamic Transactional Legislation, and is approved by the Central Bank of Malaysia. The first and second *takaful* operators in Malaysia adopted *mudarabah* principle as their business model with slight modifications (also known as modified *mudarabah*). Under the pure *mudarabah* principle, participants will provide capital (by paying contributions) to be invested by *takaful* operators (which play their role as entrepreneurs) and when there is profit, it will be shared between both parties according to pre-agreed ratio. However, as mentioned earlier, this is not the case since both parties share in underwriting surplus rather than direct investment profit.

Initially, this model which is also known as the 'Malaysian model' has gained significant popularity amongst industry players as well as customers especially in the Asia Pacific region due to its profit-sharing characteristics. However, recent scholastic discussion highlights that this model may no longer be defended since it is full of controversies. Indeed, one of the founding *takaful* scholars of Malaysia recently admitted that his biggest mistake was no other than suggesting *mudarabah* as a business model. Nevertheless, this model was still used by the two *takaful* companies at the time of research.

Other operators in Malaysia adopt the modified *wakalah* model in their business operation. This model, in its pure form, is essentially an agent-principal relationship, whereby the *takaful* operator acts as agent on behalf of the participants and thus earns a fee for services rendered. The model is now considered to be less controversial and continues to gain popularity among operators worldwide in preference to the *mudarabah* model discussed. To some writers, this former model is considered as more effective (and *Shari`ah*-compliant) for the *takaful* practitioner. Another model which is a refinement of the *wakalah* model (i.e.*wakalah* with *waqf*) is currently not applied in the Malaysian *takaful* industry. However, based on recent scholastic discussions, it seems that this model might be implemented by the *takaful* operators in the near future.

Issues Surrounding Commercial Takaful Model:

A number of *Fiqh* issues have been raised by Islamic scholars regarding both the *mudarabah* and *wakalah* models. However, the former model seems to have bigger *Shari`ah* concerns than the latter. The main issue centres upon how contribution paid by participants should be regarded. Should these contributions be regarded as capital for *mudarabah* contract or should they be regarded as a total donation to a charitable fund? By observing the *modus operandi* of this model, it seems that participants' contributions are regarded both as donation (*tabarru`*) and capital for a profit-sharing venture (*mudarabah*) at the same time. This issue is prevalent in the general *takaful* products as opposed to the family *takaful* products where participants' contributions are clearly divided into two separate accounts, namely: the risk fund (based on the *tabarru'*) and the investment fund (based on *mudarabah*). The combination of these two principles appears to be conflicting in nature however, and thus might cause the contract to be null and void from the *Shari`ah* point of view.

Another issue includes the sharing of underwriting surplus between participants and operators, and between the participants themselves. This issue arises due to the nature of the underwriting surplus which is merely a balance of participants' contributions after deducting claims and other expenses and does not necessarily mean profit. Therefore, sharing this surplus between participants and operators might violate the stipulation of profit distribution under the principle of *mudarabah,* since there is no profit in the first place. Some authors even criticize the practice, which makes the contract basically similar to the conventional insurance contract. Apart from this, participants have no rights towards the surplus since they have relinquished their rights when giving or paying contributions as a donation (*tabarru`*).

The next issue relates to the requirement by Central Bank of Malaysia regulations for operators to provide an interest-free loan (*qard hasan*) in the case of fund deficit in paying claims. This practice seems to be a form of guarantee (*kafalah*) from the operators and thus might nullify the contract due to the conflict set up between two essentially different principles (i.e. *mudarabah* and *kafalah*). Another issue includes the charging of at least three types of expenses to the *mudarabah* fund (operational, administrative and marketing) which Islamic scholars tend to discourage operators from charging.

Several *Fiqh* issues have also been raised by scholars regarding the *wakalah* model especially when the operators combine the *wakalah* principle with the profit-sharing (*mudarabah*) principle (also known as the modified *wakalah*). In Malaysia, the majority of *takaful* operators who opt for the modified model use the *wakalah* principle for managing the risk fund, but *mudarabah* for the investment account. Apart from receiving *wakalah* fees and share of the *mudarabah* profit, they are also entitled to share some of the underwriting surpluses, if any, under the term "performance incentive fee". Although the practice (surplus sharing) is actually meant to motivate the operators to better manage the risk, it may seem odd that the participants have to share any excess contribution with shareholders.

Another issue relates to the amount of donation (*tabarru`*) deducted from the participants' contributions. It is a standard practice for operators who opt for the *wakalah* model to allocate higher ratio of *tabarru`* (up to 90 percent) from contribution payments during the early years of *takaful* policy. As a result, only a small percentage will be invested according to the principle of *mudarabah* and the participants would only get a small amount of money, if they were to cancel their policy much earlier before it is actually matured. This practice has raised doubts amongst policyholders who join certain *takaful* products for saving purposes instead of for protection against risks.

Apart from the issues mentioned above, there are several 'generational matters' in both commercial *takaful* models. For example, contingency reserves may not be equitable between generations as the operators are likely to hold higher proportionate reserves in the early years for future contingencies. In a pure co-operative or mutual Islamic insurance, instead of depending on contingency reserves, fund deficit could be resolved by calling participants for additional contributions on a pro-rata basis. Another generational issue arises from the *qard hasan* for deficits. As mentioned earlier, shareholders are required to give an interest free loan in the case of fund deficit (after contingency reserves exhausted). However, the loan might be returned by future generations which are different from those who give rise to the deficit. Since the participants keep changing on a continuous basis, it leads to an intergenerational equity issues.

Conclusion:

From the above discussion, it seems that mutuality in Islamic insurance may lose its ground, although the term *takaful* itself brings the meaning of 'mutual guarantee'. To some authors, contemporary Islamic insurance industry has adopted a superficial mutuality notion in its name (*takaful*), but not in essence. This is supported by evidence that all *takaful* companies in Malaysia are structured with the shareholders rather than policyholders ownership. Although there is no evidence that shows Islam is against this kind of arrangement, to a certain extent it will affect the credibility of the industry as indicated by several issues raised by Muslim scholars. Most of the issues which are mentioned earlier, if not all, are associated with the conflict of interest between the shareholders and the policyholders as a result of *takaful* 'commercialization'. In fact, the modified models (either *mudarabah* or *wakalah*) might be proposed by the *takaful* operators to ensure that reasonable profits will be available to shareholders.

Therefore, further research need to be conducted to investigate and analyze all the issues mentioned earlier in the light of Islamic jurisprudence. In doing so, divergent views of Islamic scholars (especially from Malaysia and Middle Eastern countries) need to be reconciled with the hope that a consensus-based, if not uniform, *takaful* model will materialize not only in Malaysia but also worldwide.

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