Standing Committee
for Economic and Commercial Cooperation
of the Organization of Islamic Cooperation (COMCEC)

COMCEC

Improving the Takaful Sector In Islamic Countries

COMCEC COORDINATION OFFICE
October 2019

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AAOIFI	:	Accounting and Auditing Organization for Islamic Financial Institutions
ADR		Alternative Dispute Resolution
AIAC	:	The Asian International Arbitration Centre
APICORP	:	Arab Petroleum Investments Cooperation
BAT	:	Banks Association of Turkey
BIIC	:	Bahrain Islamic Insurance Company
BIST	:	Borsa Istanbul (Turkey)
BMT	:	Baitul Mal wa Tamwil (Indonesia)
BNM	:	Bank Negara Malaysia (Central Bank of Malaysia)
BOE	:	Bank of England (UK)
BRSA	:	Banking Regulation and Supervision Agency (Turkey)
CAGR	:	Compound Annual Growth Rate
CBMA	:	Central Bank of Malaysia Act
CBRT	:	Central Bank of Republic of Turkey
CIIN	:	Chartered Insurance Institute of Nigeria
CMA	:	Capital Market Authority (Oman)
CMB	:	Capital Market Board (Turkey)
COMCEC	:	Standing Committee for Economic and Commercial Cooperation of the Organization of the Islamic Cooperation
CSR	:	Corporate Social Responsibility
DASK	:	Doğal Afet Sigortaları Kurumu (Natural Disaster Insurance Institution, Turkey)
DIIC	:	Dubai Islamic Insurance Company (United Arab Emirates)
DMI	:	Dar al-Mal al-Islami (UK)
EUR	:	Euro
FAS	:	Financial Accounting Standard
FCA	:	Financial Conduct Authority
FSA	:	Financial Services Act (Malaysia)
FSDP	:	Financial Sector Development Program (Saudi Arabia)
FSMP	:	Financial Sector Master Plan
GBP	:	British Pound
GCC	:	Gulf Cooperation Council
GREs	:	Government-related Entities
GWC	:	Gross Written Contributions
GWP	:	Gross Written Premiums
IAC	:	Insurance Arbitration Commission (Turkey)
IAIS	:	International Association of Insurance Supervisors
IAT	:	Insurance Association of Turkey
ICD	:	Islamic Cooperation for the Development of the Private Sector
IFDI	:	Islamic Finance Development Indicator
IFI	:	Islamic Financial Institution
IFRS	:	International Financial Reporting Standard
IFSA	:	Islamic Financial Services Act (Malaysia)
IFSB	:	Islamic Financial Services Board
IFTF	:	Islamic Finance Task Force (UK)
IIAL	:	Islamic Insurance Association of London (UK)
IIFA	:	International Islamic Fiqh Academy
IILM	:	International Islamic Liquidity Management Corporation
IIMC	:	Insurance Information and Monitoring Centre (Turkey)
IPO	:	Initial Public Offering

IsDB	:	Islamic Development Bank
ITC	:	Insurance Training Centre (Turkey)
MAR	:	Minimum Allocation Rate
MDBs	:	Multilateral Development Banks
MENA	:	The Middle East and North Africa
MIFC	:	Malaysian International Islamic Financial Centre
MTA	:	Malaysian *Takaful* Association
MVB	:	Motor Vehicles Bureau (Turkey)
MYR	:	Malaysian Ringgit
NGO	:	Non-Governmental Organization
NPM	:	Net Profit Margin
NWP	:	Net Written Premiums
OECD	:	Organization for Economic Cooperation and Development
OIC	:	Organization of Islamic Cooperation
ORYM	:	Olağandışı Riskler Yönetim Merkezi (Extraordinary Risk Management Centre, Turkey)
OTC	:	Over the Counter
PA	:	Participant's Account
PBAT	:	Participation Banks Association of Turkey
PBUH	:	Peace be upon him (for Prophet Muhammad)
PIF	:	Participant Investment Fund
PMC	:	Pension Monitoring Centre (Turkey)
PPP	:	Public Private Partnership
PRA	:	Prudential Regulation Authority
PRF	:	Participants' Risk Fund
PSA	:	Participants' Special Account
QD	:	Quantitative Development
RBC	:	Risk-Based Capital
RBCT	:	Risk-Based Capital for *Takaful*
RSA	:	Regulatory and Supervisory Authority
RTO	:	*Re-Takaful* Operator
SAC	:	*Shari'ah* Advisory Council
SAMA	:	Saudi Arabian Monetary Authority
SAR	:	Saudi Riyal
SDIF	:	Savings Deposit Insurance Fund of Turkey
SEA	:	South-East Asia
SECP	:	Securities and Exchange Commission of Pakistan
SLC	:	Student Loans Company
TASF	:	*Takaful* Alternative Student Finance
TIIW	:	Turkish Insurance Institute Waqf
TO	:	*Takaful* Operator
TOBB	:	Türkiye Odalar ve Borsalar Birliği (The Union of Chambers and Commodity Exchanges, Turkey)
TP	:	*Takaful* Participant
TRY	:	Turkish Lira
TÜSAF	:	Türkiye Sigorta Acenteleri Federasyonu (Insurance Agents Federation, Turkey)
UKTI	:	UK Trade and Investment
US$	:	United States Dollar

EXECUTIVE SUMMARY

Modern insurance had attracted the attention of Muslim scholars and economists, since the the 19th century, when the majority of Muslim countries were subjected to colonisation and therefore to illiteracy, ignorance, suppression and division by western colonisation and lost their civilizational lead. In the early Islamic societies, every member of the community was automatically insured by his relatives, neighbours and by the Islamic state against any misfortune that may happen to him. That is why some of the contemporary Muslim scholars, like Abdullah Al-Qalqeeli (1961), Shawkat Al-Ulayyan (1981), Suleyman Al-Thenayan (1993) and others think that there is no need for commercial or even *Takaful* insurance companies to exist. However, given the complexity of life and the need for organised insurance, contemporary Muslim scholars agree that solidarity and cooperation among the people are not only recognised but encouraged in any form possible, including organised insurance (Chachi, 2017).

In this continuation, the demand for *Takaful* has been augmenting along with the demand for Islamic finance. Verily, the rapid development of Islamic finance has necessitated the need for *Takaful* or Islamic Insurance. *Takaful* operates in line with *Shari'ah* principles and, at the same time, offers the benefits and services equivalent to its conventional counterpart. Therefore, it has evolved in response to the ever-increasing for an insurance system that is Islamic and provides risk coverage for individuals and Islamic financial institutions (IFIs). For this reason, the study focuses, in particular, on the *Takaful* industry.

The main objective of this study is to provide an analysis on the (i) theoretical and legal natures of *Takaful*, including the interpretation of various schools of thought on the comparison of conventional and Islamic insurance; (ii) detailed analysis on the current size and trends, structures, modes, and instruments of *Takaful*; (iii) operational aspects of *Takaful* business, a comprehensive and detailed analysis on types of *Takaful* structures, structural, regulatory and technical challenges facing *Takaful* sector; (iv) country analysis for the selected countries on *Takaful* market. Based on the analysis of *Takaful*, the study also provides policy recommendations on Improving the *Takaful* Sector in the Islamic Countries, members of the Organization of Islamic Cooperation (OIC) and related issues by taking into consideration case studies of three selected OIC member countries and one non-OIC country.

The study applies various approaches to collect data and analyse the *Takaful* industry in the four case studies. This includes literature review, surveys with semi-structured interviews and structured questionnaires. The literature review is used to set up a framework for *Takaful* industry analysis for deriving the best practices. Surveys include both structured questionnaires and semi-structured interviews. The survey questions include the following sections: background information, challenges facing the *Takaful* industry, and company-level SWOT analysis.

Four countries have been selected as sample countries to analyse the improvement of the *Takaful* sector. The sample includes three OIC countries: 1) Saudi Arabia with 100 per cent *Takaful* -based economy, 2) Malaysia with the dual banking and *Takaful* systems, and 3) Turkey with its emerging Islamic finance industry. The study also includes the United Kingdom (UK) as a non-OIC country – an economy with IFIs for more than thirty years.

According to Thomson Reuters Report (2018), there are more than 1,389 full-fledged IFIs and windows worldwide. From 2012 until 2017, the Islamic finance industry has been recording a compound annual average rate of growth of 6%. It is also reported that Iran, Saudi Arabia, and Malaysia remained the most significant market contributors to top global Islamic banking markets in 2017. Consequently, with the fast growth of the Islamic financial industry, the *Takaful* market has gained a high momentum, even though *Takaful* contribution is still too small compared to other markets in the Islamic finance industry.

Thomson Reuters Report (2018) also reported that the total assets of global *Takaful* industry grew up to US$ 46 billion in 2017 with 324 number of *Takaful* operating companies, including more than 112 General *Takaful* Operators (TOs) and 76 life TOs around the world. For composite *Takaful*, there are 113 composite *Takaful* and 21 Re-*Takaful* Operators (RTOs) around the world — the number of operators based on the total assets in the global *Takaful* market of 2017.

With this significant number of existing *Takaful* companies, the insurance market is embracing new *Takaful* operators along with a huge customer demand for this sector in many countries. In this context, the study has analysed the performance and potentiality of four countries – three OIC member countries (Malaysia, Saudi Arabia and Turkey) and one non-OIC member country (UK) – regarding the economic and legal aspects, in order to comprehend the current development and position of this sector. A brief exposition of these countries' *Takaful* sectors is summarised below:

Malaysia

Malaysia is the leader of the *Takaful* industry in South East Asia. It has firmly established the supportive infrastructures required for sustainable Islamic finance, particularly, in product development, institutional establishment, as well as thought leadership. The governmental support has always been a significant factor driving the growth of the Islamic finance market in Malaysia, particularly in creating the proper infrastructure for Islamic finance to flourish. Malaysia's regulatory approach is to adjust its regulatory environment, in order to facilitate the integration of *Takaful* and promote its growth through appropriate amendments in the legislature. The positive growth of the *Takaful* industry in Malaysia is supported by several drivers such as the resilient, ever robust regulatory infrastructure and conducive environment created by Bank Negara Malaysia (BNM). BNM has revised the standards issued in January 2019 related to Life insurance and Family *Takaful* (LIFE framework).

According to the Malaysian *Takaful* Association (2018), the conventional and *Takaful* insurance sectors of Malaysia earned higher total premiums and contributions, which increased by 4.9% (from MYR 63.5 to MYR 66.6 billion) in 2017. Alongside, the total assets of these sectors also increased by 3.2% (from MYR 299.5 billion to MYR 309.1 billion) in the same year.

Family *Takaful* business has shown double-digit growth in Malaysia. The total new business contributions have increased from MYR 4.35 billion in 2017 to MYR 4.91 billion in 2018. For new business single contributions, Family *Takaful* products contributed from MYR 3.12 billion to MYR 3.64 billion. Next, the new business annual contributions in 2017 have increased from MYR 1.22 billion to MYR 1.27 billion in 2018. Other than that, 699,534 certificates were issued to the policyholders in 2018. There has been an increase from 2.3% to 4.6 % in 2018. The demand for Family *Takaful* increased rapidly over the years.

After analysing the overall Malaysian *Takaful* market, some lessons are conspicuous to observe. Firstly, a regulatory evolution and a short-term slowdown in growth. Secondly, the sustainability of pension schemes and retirement planning.

Saudi Arabia

Saudi Arabia is the largest *Takaful* market in the world (with 38% of global *Takaful* contributions), followed by Iran (34%), Malaysia (7%) and the UAE (6%) (IFSB, 2018). However, as a result of the economic slowdown, due to low oil prices, the growth in Saudi Arabia dropped to 2.1%. In Saudi Arabia, the *Takaful* industry, which is called cooperative insurance, is based on a cooperative model enforced by the Cooperative Insurance Companies law issued in 2005.

It is important to note that the Saudi Arabian insurance industry and its legal framework has relatively a long history, which is backdated to the 1930s of the last century with the entrance of the international oil companies to explore oil where they have insured their equipment, labours, and their oil tankers.

The Gross Written Premiums (GWP) of General insurance grew from SAR 3,589.9 million in 2005 to SAR 14,028.4 million in 2018. Similarly, Health insurance grew from SAR 1,370.3 million in 2005 to SAR 19,883.4 million in 2018. On the other hand, life insurance GWP did not increase much compared to the other two types. It was SAR 193.2 million in 2005 and grew to SAR 1,008.3 million in 2018.

After analysing the overall Saudi Arabian *Takaful* market, it appears that there are some issues that need to be resolved for further development of the industry in the Kingdom, e.g., the need for *Shari'ah* regulatory framework for the *Takaful* industry and the need for *Re-Takaful* Companies to cater to the need of the *Takaful* industry.

Turkey

Even though the Islamic banking and finance started late in Turkey, however, the World Islamic Banking Competitiveness Report reported that Turkey is very important to the global growth of the Islamic banking and finance industry due to strong support from the Turkish government. Recently, there has been a significant success in the growth and development of the *Takaful* sector in Turkey with the introduction of new players. The market share of *Takaful* increased fast after the introduction new market players. As of 2018, the total market size of participation insurance (*Takaful*) was TRY 2.23 billion while it was only around TRY 383 million in the year 2014. In terms of total market share, it accounted for only 1.51% market share in the total insurance sector in year 2014. However, it accounted 4.31% market share in year 2018 with a significant increase.

On the other hand, it can be seen that the volume of General *Takaful* was TRY 380 million in the year 2014 and it was more than TRY 2 billion in year 2018. Alongside, there was 6-7 times increase in year 2018 compared to year 2014 and notable growth 70.1% in year 2018. The main driver of the growth is entrance of new players in the market. A similar strong growth effect is expected after licencing of the newly registered General *Takaful* company. The Family *Takaful* is relatively small compared to General *Takaful*. It was only around TRY 3.37 million in year 2014 while General *Takaful* was TRY 380 million.

Since Turkey is a secular country, Islamic finance is not separated from its legislative structure so the legal and regulatory institutions. Its legal and regulative structure covers the financial sector in three main groups (banking, capital, and insurance) and for each group generally, there is only one primary regulator. As a result, legal and regulatory institutions are typical for conventional and Islamic finance. The legal and regulatory environment is separated into two in the dual insurance system economies. However, the Turkish insurance market may not be considered as a dual system since the legal and regulatory environment has one standard insurance act.

As with Malaysia and Saudi Arabia, after analysing the overall Turkish *Takaful* market, some lessons can be learnt that may support further the growth and development of the industry in the country, e.g., the emphasis on compliance and governance, strong support of the government with long-term strategies for expanding the market, new players should be encouraged to invest in *Takaful* industry, and the importance of developing legal framework especially on accounting which causes obstacles for better representing the *Takaful* concept.

The United Kingdom

The insurance market in the UK is considered to be the largest in Europe and the fourth largest in the world. Apart from the gains registered in the domestic insurance market, one unique feature of the UK's insurance market is the global role it plays, as an exporter of insurance services to other countries.

With regards to *Takaful*, there have not been proactive steps by the government to promote this faith-based insurance model. However, the government through the Department for Business, Innovation and Skills explored the possibility of introducing an alternative student finance scheme, specifically for students whose religious beliefs forbid them from taking interest-bearing student loans.

Just like the other aspects of the Islamic financial services industry in the UK, the *Takaful* sector is regulated under the existing legal and regulatory framework for insurers and reinsurers. The insurance industry, as well as the *Takaful* sector, are governed by the Financial Services and Markets Act 2000 as amended, and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

Despite a noteworthy growth of the *Takaful* industry in the UK, the sector is facing many issues and challenges due to legal issues related to product innovation and to the acceptance of the Muslim general public of the *Takaful* products. The legal issues have transformed into new challenges, including the inability of the *Takaful* sector to meet up with the fast-paced developments in the conventional insurance industry. Many other challenges have also been identified. These include inadequate awareness among the faith-based financial consumers, the lack of political will, the inadequate *Re-Takaful* capacity, the limited investment options, the inadequate skilled human resources, the weak regulatory support, the inadequate distribution capacity and the minimal efforts undertaken up to now in research and development.

Recommendations are suggested, based on the analysis of the steps that need to be taken. These recommendations are classified into phases, such as operating landscape, legal and regulatory framework, product development and technology innovation, human capacity building, and *Takaful* business sustainability.

The key issues and policy recommendations for the *Takaful* industry to develop further, and to become a business as usual worldwide, especially in OIC member countries include:

- Addressing the structural, regulatory, technical, academic and other main challenges that inhibit the development and promotion of Islamic finance for *Takaful*.
- Addressing the issues and challenges at the local, regional and global levels and propose adequate *Shari'ah* compliant solutions.
- Providing practical solutions to the ever-emerging issues and recommend solutions and policies based on this study for improving/strengthening Islamic finance for *Takaful* in the OIC member countries.
- Standardising the best practices of *Takaful* insurance and making them ready to be implemented in most, if not all, OIC member countries.

CHAPTER 1: INTRODUCTION

This chapter, briefly, introduces the scope of the research, and explains the methodology used in dealing with the subject matter of the project.

1.1. Background of the Study

Although, "it is still not known when organised insurance actually started, and in what type of group it was developed" (Clayton, 1971:13), there is clear evidence, however, that the so-called bottomry contracts (Shipping Insurance) were known to merchants of Babylon in Mesopotamia as early as 4000-3000 years BC (Kasim, Htay, & Salman, 2016).

There are also ample pieces of evidence that many, if not all, civilisations (Babylonians, Egyptians, Greeks, Romans, Arabs, and others) knew some form of mutual insurance. In essence, insurance types were known to all earlier civilisations and developed further with the development and advancement of the society, especially in the Islamic civilisation and later in Europe and in the rest of the world (Chachi, 2017). From the above-mentioned historical facts, it appears that mutual cooperative insurance, whereby members of a group (family members, for example) took care of the needs of the other members, is perhaps one of the oldest transactions known to mankind and practised by many, even long before trade and industry.

Modern insurance may be historically recent, but the essence of insurance, whereby more than one person come together and help each other overcome the risks and misfortunes of life that may befall any of them, is as old as humanity and was known to all human societies across time and civilisations. It is, as Mulhim and Sabbagh (nd:3) put it: "*one of the means people have used for ages to deal with the consequences of damages, risks, and disasters which befall them in order to alleviate their impact or to avoid them completely*".

Modern insurance had attracted the attention of Muslim scholars and economists, since the second half of the 19th century, when many Muslim countries were subjected to colonisation and therefore to illiteracy, ignorance, suppression and division by western colonisation and lost their civilizational lead (Chachi, 2017). Before that, somehow, there was no real need for insurance in Muslim communities, as the members of the small communities took care of each other by many tools and means such as *zakah*[1], *sadaqah* (charity), *awqaf*[2] and *Takaful ijtima'i* (social solidarity), advocated by Islamic teachings. However, with the cosmopolitan nature of modern societies and complexities of life, where people living in the same neighbourhood, rarely know one another, let alone meet or care about each other, it has become absolutely necessary to structure a modern form of insurance, to take care of every member of the society.

The question of whether modern insurance is permissible in Islam or not has been and remains the subject of heated debates and controversy among Muslim scholars across the Muslim World

[1] A form of alms-giving treated in Islam as a religious obligation.
[2] An inalienable charitable endowment under Islamic law.

since the beginning of the 19th century. Unlike the issue of usury (*riba*), which is well defined in the primary sources of Islam - the Holy Qur'an and Sunnah - as anything required by a lender from a borrower above the principal of a debt or a loan (as explained in *surah* "al-Baqarah", verse 275), mutual solidarity, cooperation and insurance are left to the *ijtihad* (independent legal deduction) of Muslim jurists, to decide upon, depending on the *maslahah* (public benefit or utility). This has resulted in different opinions (Chachi, 2017).

Therefore, with the advancement in civilization, emergence of nation-states across the world and the rising volumes of trade and commerce and the resulting complexity of life, new risks emerged in an increasing manner that required the attention of policymakers. The more mankind looks into the future, the more they encounter inexplicable uncertainties as Sidiqqi (2000) pointed out. He argued that: "*handling risk and uncertainty became an increasingly prominent aspect of economic life, even for ordinary men and women. Early ways and means of handling risks and uncertainty took simple forms of cooperation between the near and the dear. Pooling, sharing, diversification all occurred within the framework of trust, reciprocity and mutuality. That was insurance/Takaful*". Sidiqqi (2000) further reasoned: "*As uncertainties increased and risk became more complex, shifting risks to those willing to take them (in expectation of gain, of course) and unbundling them into manageable parts took new forms*".

Against the background of the main Islamic principles of cooperation and social solidarity, preserved in the Qur'an and Sunnah, every member of the early Islamic societies was automatically insured by his relatives, neighbours and by the state against any misfortune that may happen to him. That is why some of the contemporary Muslim scholars, like Abdullah Al-Qalqeeli (1961), Shawkat Al-Ulayyan (1981), Suleyman Al-Thenayan (1993) and others, think that there is no need for commercial or even *Takaful* insurance companies to exist. However, given the complexity of life and the need for organised insurance, contemporary Muslim scholars agree that solidarity and cooperation among the people are not only recognised but encouraged in any form possible, including in an organised manner that would help in achieving the original value proposition of Islamic economic principles. However, they disagree on the form of solidarity and cooperation that such solidarity and cooperation may take. This is undoubtedly in view of its great importance in reducing the impact of risk and uncertainties, collecting contributions from member contributors, investing the contributions in profitable businesses, employing staff to manage them, compensating the victims of misfortunes and thus, contributing to economic growth and development and also contributing to social harmony and political stability of the state.

The Islamic finance industry is made up of three sections: Islamic banking, Islamic capital markets and Islamic insurance or *Takaful*. Among other segments of Islamic finance, Islamic insurance, which is called *Takaful* is the objective of this study. Being one of the major constituents of the modern Islamic finance industry, the theory and practice of *Takaful* are based on fundamental principles of Islamic finance. The concept of Islamic finance is based on some core tenets of Islam, relating to just wealth distribution, property rights, social and economic justice, and proper good governance. Given the Islamic finance industry's current volume and composition, Islamic finance has become an integral part of the global financial system. It has distinctive features that could be used to reconcile the global financial system with Islamic law – the *Shari'ah*.

The fast rates of growth of the Islamic finance industry have been accompanied by geographical spread into not only Muslim-majority countries but also non-Muslim economies. With the worldwide spread of Islamic finance, there has been a significant growth in thought leadership through related books, monographs, reports and academic articles on Islamic finance. Since the emergence of the modern Islamic finance industry in the 1960s, there has been a continued and accelerated development of Islamic finance, which has been gathering momentum with specific regional and global developments during the past five decades. Nevertheless, *Takaful* has not achieved a similar achievement in its own unique segment, as it continues to struggle to expand its frontiers within the Muslim world and to gain a considerable market share in a world dominated by conventional insurance. This makes a case for the need to improve the *Takaful* sector in Muslim jurisdictions across the world – an objective this study that seeks to achieve in a comprehensive manner.

1.2. Objective of the Study

The main objectives of this study is to (i) provide an analysis of the theoretical and legal nature of *Takaful*, including the interpretation of various schools of thought (*madhahib*) on the comparison of conventional and Islamic insurance; (ii) give detailed analysis on the current size and trends, structures, modes, and instruments of *Takaful*; (iii) explain the operational aspects of *Takaful* business, including a comprehensive and detailed analysis on types of *Takaful* structures, structural, regulatory and technical challenges facing *Takaful* sector; (iv) do country analysis on the selected countries on *Takaful* market.

Based on the above-mentioned objectives, the study will provide policy recommendations to the OIC Member countries on *Takaful* structures and related issues, by taking into consideration the OIC and non-OIC members case studies.

1.3. Summary Contents of the Study

The study contains eight chapters, the overview of which are presented in the *Table 1* below:

TABLE 1: CONTENTS OF STUDY

CHAPTER 1: Introduction	This chapter, briefly, introduces the subject matter of the study, the objective of the research, and explains the methodology used.
CHAPTER 2: Conceptual Framework of *Takaful*	This chapter defines *Takaful*, discusses its importance for economic development from a theoretical perspective, and provides an overview of *Takaful* needs in OIC member countries.
CHAPTER 3: *Takaful* Business Models	This chapter explains the various *Takaful* business models and provides a comprehensive and detailed analysis on types of *Takaful* structures by focusing on the establishment, management and contribution payments along with the *Shari'ah* guidelines primarily in the OIC member countries as well as non-OIC countries. It analyses each type of the contractual relationships in *Takaful* by considering the *Takaful* standards and general practices.
CHAPTER 4: The *Takaful* Global Landscape	This chapter provides a brief analysis of the needs and trends of the *Takaful* industry at global, regional and country levels. It also analyses the legal structure, setting-up and working mechanisms of *Takaful* structures in the market.
CHAPTER 5: Issues, Challenges and Future of the *Takaful* Industry	This chapter illustrates the structural, regulatory and technical issues and challenges, that are facing the *Takaful* market, on standardisation, taxation, competitiveness and bankruptcy.
CHAPTER 6: Country Case Studies and Survey Analysis	In this chapter, four countries, including one non-OIC country, are selected as case studies. Besides the analysis of the relevant primary data, the chapter also provides high-level reports on field-visits to three OIC countries. In addition to the official institutions of the selected countries, other stakeholders, utilising the *Takaful* financing mechanism, such as private banks, investment banks, investment companies, international development institutions were also visited to understand the working mechanism of *Takaful* financing as well as the challenges and issues in the market. Selected countries are analysed in detail by focusing on *Takaful* through Islamic finance in the light of the findings of the previous chapters considering the legal and regulatory framework as well as current trends, sizes, challenges and issues.
CHAPTER 7: Policy Recommendations	This chapter draws up general policy recommendations on the *Takaful* sector in the OIC countries within the context of the deficit, financing mechanisms, modes and instruments, the status of legal and regulatory frameworks. Policy recommendations are designed in the form of a roadmap which the OIC member countries could benefit from in their efforts toward developing and promoting Islamic finance through the improvement of the *Takaful* sector. It explains the rationale behind each policy recommendation, in order to pave the way for the implementation of the best management practices in the OIC member countries, and transfer knowledge and share experiences for the development of the *Takaful* sector.
CHAPTER 8: Conclusion	This chapter summarises the study and provides a brief conclusion.

References and the Appendix are placed at the end of this study.

1.4. Methodology

The study employs various approaches to data collection and analysis. A comprehensive approach includes two stages: 1) primary and secondary data collection, as well as case studies review; and 2) synthesis comprising of drafting conclusions and recommendations based on obtained results. The literature review is used to set up a framework for *Takaful* industry analysis for deriving the best practices. The surveys include both structured questionnaires and semi-structured interviews.

The questionnaire contains three sections: background information, challenges facing the *Takaful* industry, and company-level SWOT analysis. The section on background information collects data on the area of specialisation or occupation of the respondent, and his country of residence (the options are Malaysia, Saudi Arabia, Turkey, and the UK). There are six options given for occupation. These are: (1) industry player, (2) *Shari'ah* expert, (3) IT professional, (4) regulator, (5) academician/consultant, and (6) other. The first three categories of specialisation are considered as internal to the *Takaful* company; hence, the additional questions are asked to indicate the category of the company: the full-fledged *Takaful* company, *Takaful* window, subsidiary of the full-fledged *Takaful* company, *Re-Takaful* company, or *Re-Takaful* window. These were followed by another question on the type of *Takaful* business plan offered (General *Takaful*, Family Takaful, Composite, or others), which *Takaful* business model adopted (*Wakalah* model, Modified *Wakalah* model, *Mudarabah* model, Modified *Mudarabah* model, *Wakalah-Mudarabah* hybrid model, Waqf model, or Cooperative model), and whether the company is publicly listed or not.

The section, on the issues and challenges facing the *Takaful* industry, covers eight potentially challenging areas. These are:

1) ***The Political and macroeconomic environment*** which includes survey questions about political uncertainty, macroeconomic conditions, and market confidence.
2) ***The Regulatory framework*** which covers questions on legislation, transparency and disclosure, taxation, and capital requirement and solvency margins,
3) ***The Business operations*** which collects opinions on new business models, quality of operation and, product development and innovation.
4) ***The Technology*** related questions including FinTech (InsurTech) and Cybersecurity.
5) ***The Shari'ah framework*** related to *Shari'ah* governance, *Shari'ah* standards, *Shari'ah* board and *Shari'ah* audit.
6) ***The Infrastructure*** related questions such as distribution channels, availability of *Re-Takaful* services and availability of *Shari'ah*-compliant instruments for investment.

7) ***The Market*** analysing questions such as challenges from competition from *Takaful* companies, competition from conventional insurers, weak customer base, and low consumer awareness.

8) ***The Human capital*** section including the lack of qualified personnel, inadequate education and continuous development, and inadequate training for agents and brokers.

The section on company-level SWOT analysis includes the questions about the internal and external factors that the respondent believes are critical for the growth of the *Takaful*/*Re-Takaful* company, such as:

1) ***Strengths for the development of the industry, protecting the existing market share and penetrating new markets*** are the use of technology and automation to sustain the quality of services; successful product development and innovation; the high level of customer satisfaction; well-developed distribution network; strong free cash flow for further expansion of projects; the high rate of return on *Shari'ah*-compliant investments; having high-skilled workforce; and the diversification across countries.

2) ***Weaknesses which should be addressed to build on the company's competitive edge and strategic positioning*** include the high attrition rate in workforce; a lack of efficient financial planning; rigid organization structure to accommodate new business models; poor marketing strategies; and a lack of investment into research and development (R&D).

3) ***Opportunities for the success of the company*** are the strong support from the government for development of the industry; new customers via online channels; access to new insurance technology; future growth due to political and economic stability; and expansion in other countries.

4) ***Threats to the development of the company*** include the intense competition from *Takaful* operators and conventional insurers; new restrictive regulations; the irregular development and supply of new products; vulnerable cybersecurity; and the high bureaucracy level as an impediment to growth.

The interviews include the following ten questions about the *Takaful* industry:

1) How do ***the macroeconomic environment, political uncertainty and market confidence*** influence the *Takaful* industry and what are the counter measures that need to be taken?

2) How do ***legislation, transparency, disclosure, taxation, capital requirements and solvency margins*** play roles in strengthening the *Takaful* industry and what are the counter measures that need to be taken?

3) How can ***product development, innovation, new business models, and quality of operations*** play roles in the growth of the *Takaful* industry and what are the counter measures that need to be taken?

4) Whether the ***Shari'ah framework*** play a crucial role in the *Takaful*?
5) What are the measures that should be taken to improve the ***infrastructure*** in the *Takaful* industry?
6) What should be done at the ***market level*** to strengthen the competitiveness of the *Takaful* industry against its conventional counterpart?
7) What should be done to enhance the ***human capital*** level of the *Takaful* industry?
8) How effective are the ***regulations and market practices on consumer protection, and the mechanism of dispute resolution*** in the *Takaful* industry?
9) How can ***FinTech*** be used to strengthen the *Takaful* industry and what are the measures that should be undertaken?
10) How do you ***foresee the future*** of the *Takaful* industry?

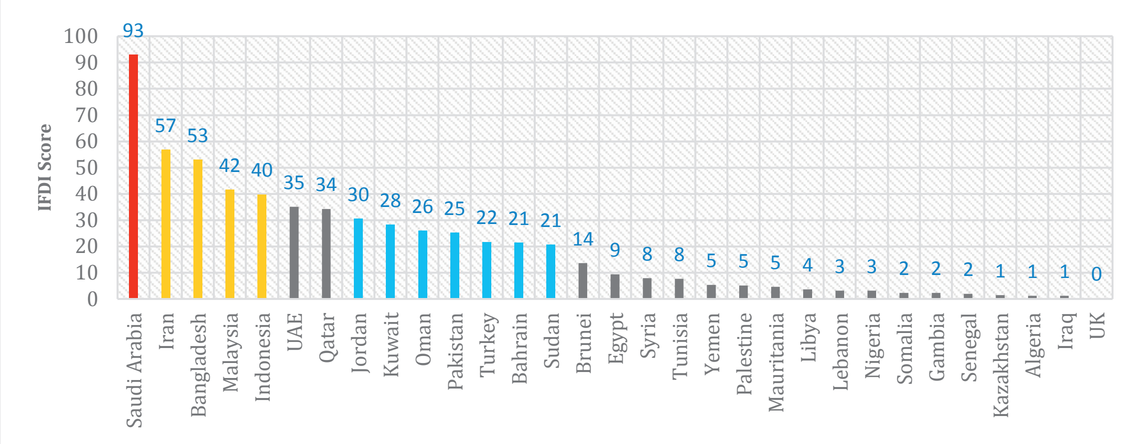
These surveys are expected to facilitate the assessment of the *Takaful* industry and, consequently, help in the formulation of policy recommendations for the development of the *Takaful* industries in Islamic countries.

Country selection criteria: Three OIC member countries – Malaysia, Saudi Arabia, and Turkey and one non-OIC country – the UK have been selected from the sample of countries to analyse the dynamics on how to improve the *Takaful* sector. The selection process was not based on a random method; rather, there were specific criteria that facilitated the selection of these four jurisdictions. As the main criterion for screening the countries we apply Islamic Finance Development Indicator (IFDI) from Thomson Reuters[3], specifically its subcomponent - the *Takaful* development indicator. Next, we apply the second filtering criterion - economic freedom score developed by Heritage[4] which helped in choosing the relatively better-performing economies.

[3] Islamic Finance Development Indicator (by the ICD and Thomson Reuters) is a composite weighted index that measures the overall development of the Islamic finance industry by providing an aggregate assessment of the performance of all its parts, in line with Islamic principles. (See www.zawya.com/islamic-finance-development-indicator/files/IFDI-Rulebook.pdf?v2) (IFDI, 2018).

[4] Economic freedom index (by the Heritage Foundation) is an aggregate indicator that scores the relative freedom of global economies based on 10 factors: property rights, freedom from corruption, government spending, fiscal freedom, business freedom, labour freedom, monetary freedom, trade freedom, investment freedom, and financial freedom. (See www.heritage.org/index/ranking).

FIGURE 1: *TAKAFUL* INDUSTRY DEVELOPMENT SCORE



Source: IFDI

First, to select three OIC countries as a sample for this study, we have categorized them into three groups based on IFDI score (see *Table 2* below): 70-above, 40-60, and 20-30 (See *Figure 1*). Obviously, Saudi Arabia is a leading country in terms of *Takaful* industry development, the only country which falls under the first group. Next, four countries - Iran, Bangladesh, Malaysia, and Indonesia - fall under the second group. Therefore, to choose a country, we apply the second criterion (see *Table 30* in the Appendix) and select Malaysia as a group leader with the highest economic freedom score (74/100) in the year 2019.

Further, seven countries – Jordan, Kuwait, Oman, Pakistan, Turkey, Bahrain, and Sudan – form a third group based on the first criterion. Jordan and Bahrain have marginally higher economic freedom score compared to Turkey (66.5, 66.4, and 64.6, respectively). Since, according to COMCEC's classification of countries, Jordan, Kuwait, Oman, Bahrain, and Sudan belong to the Arab group same as Saudi Arabia, and Pakistan belongs to Asian group as Malaysia, Turkey was picked from the list of countries.

Meanwhile, due to the low IFDI score, the African group countries were not included in the analysis. Finally, the UK is in the list of selected countries because this is the only country which has the highest IFDI score among non-Muslim countries showing strong trends in the development of the Islamic finance industry. Also, UK carries high economic freedom score (79/100).

In summary, the sample includes three OIC countries: 1) Saudi Arabia with 100 per cent *Takaful* -based economy, 2) Malaysia with the dual banking and *Takaful* systems, and 3) Turkey with its emerging Islamic finance industry. The study also includes the UK as a non-OIC country – an economy with IFIs.

Table 2 presents the Islamic Finance Development Indicators (IFDI) for each of the sample countries. It shows that Malaysia leads other selected countries in terms of IFDI overall score

[131.86], followed by Saudi Arabia [56.08], Turkey [21.32], and the UK [14.68]; however, all of these countries have higher scores compared to the global average [10.46]. Meanwhile, the *Takaful* industry is more advanced in Saudi Arabia [92.92], followed by Malaysia [41.63], Turkey [21.71], and the UK [0.21]. Except for the UK, the sample countries maintain higher than global average *Takaful* development score [5.29].[5]

Table 2: Selected Islamic Finance Development Indicators (IFDI)

INDICATORS (2018)	GA	MY	SA	TR	UK
Islamic Finance Development Indicator (IFDI)	**10.46**	**131.86**	**56.08**	**21.32**	**14.68**
1. QUANTITATIVE DEVELOPMENT	**5.85**	**98.50**	**56.80**	**12.28**	**4.30**
Islamic Banking	9.49	66.70	58.05	18.96	2.08
Takaful	5.29	41.63	92.92	21.71	0.21
Other IFIs	5.78	102.93	38.27	1.54	0.69
Sukuk	3.99	182.29	42.82	15.08	5.08
Funds	4.68	98.96	51.93	4.11	13.45
2. KNOWLEDGE	**9.36**	**228.37**	**42.89**	**15.32**	**15.48**
Education	9.84	156.73	31.23	10.61	21.72
Research	8.87	300.00	54.54	20.03	9.23
3. CORPORATE SOCIAL RESPONSIBILITY (CSR)	**8.08**	**42.19**	**83.92**	**33.31**	**28.36**
CSR Funds Disbursed	5.48	33.88	139.39	1.80	0.00
CSR Disclosure	10.69	50.50	28.45	64.82	56.72
4. GOVERNANCE	**13.01**	**87.91**	**37.80**	**23.83**	**20.15**
Regulation	17.68	100.00	33.33	33.33	0.00
Shari'ah Governance	12.95	103.89	51.51	14.91	13.55
Corporate Governance	8.40	59.85	28.54	23.25	46.88
5. AWARENESS	**15.99**	**202.31**	**59.00**	**21.84**	**5.10**
Seminars	7.70	181.69	8.62	11.20	4.58
Conferences	7.61	156.59	14.58	37.86	6.19
News	32.65	268.66	153.81	16.46	4.53

Notes: GA – Global Average, MY – Malaysia, SA – Saudi Arabia, TR – Turkey, UK – United Kingdom.
Source: Thomson Reuters (2018)

[5] For more detailed information, please refer to *Table 28* in the *Appendix*.

CHAPTER 2: CONCEPTUAL FRAMEWORK OF TAKAFUL

This chapter defines *Takaful*, discusses its importance for economic development from a theoretical perspective, and provides an overview of *Takaful* needs in OIC member countries. The chapter provides, specifically, a brief definition of *Takaful*/*Re-Takaful* based on its nature, i.e. economic and social aspects. It explains the role and importance of *Takaful*/*Re-Takaful* for an economy, and the ways it affects and improves economic development. Further, it provides a brief theoretical background along with historical trends on its role in economic development.

2.1. Concept and Role of *Takaful* and *Re-Takaful*

Although the term "*Takaful*" has a broader literal meaning, including mutual solidarity, help, cooperation and collaboration, it has been referred to technically in the limited sense as *Shari'ah*-compliant insurance. It has been the case since the establishment of the first *Takaful* Company in Sudan in 1979.

With the emergence of Islamic banks in different parts of the world in the latter part of the 20th Century, it was noticed that there was the need for a risk management tool to support the Islamic banks and contribute further in developing the Islamic finance industry. Therefore, *Takaful* became an indispensable and complementary element of the Islamic financial system and a vital key to its success and development. Since then numerous *Takaful* models have emerged and *Takaful* companies were established to fulfil the needs of many Muslims who were hitherto self-excluded from financial opportunities such as insurance. This provided a good opportunity for them to conduct their lives in accordance with the tenets of their faith.

2.1.1. Definition of *Takaful*

Takaful refers to a mutual guarantee or assurance arrangement among a group of people facing similar risks or the danger of incurring unforeseen losses, to individually contribute a certain sum of money, which will be used to compensate any member of the group who incurs such losses (Alhabshi et al., 2012). Legally, *Takaful* is defined as "*an arrangement based on mutual assistance under which Takaful participants agree to contribute to a common fund providing for mutual financial benefits payable to the Takaful participants or their beneficiaries on the occurrence of pre-agreed events*" (BNM, 2013).

Takaful, or Islamic insurance, cooperative insurance, mutual insurance, participation insurance as it is called in different jurisdictions is defined by the International Islamic Fiqh Academy (IIFA) as follows: "*Cooperative insurance is the process in which a group of people, who face certain risk(s), agree that each of them contribute a specific amount, based on cooperation, to a non-profit fund that is to be used for compensating anyone of them for the harms he would encounter when the risk in question materializes, as per signed contracts and adopted regulatory legislations*" (OIC Fiqh Academy, 2016).

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines *Takaful* as *"a process of agreement among a group of persons to handle the injuries resulting from specific risks to which all of them are vulnerable"* (AAOIFI, 2017). In a similar but semantically different dicta, the Islamic Financial Services Board (IFSB) defines *Takaful* as "*a mutual guarantee in return for the commitment to donate an amount in the form of a specified contribution to the participants' risk fund, whereby a group of participants agree among themselves to support one another jointly for the losses arising from specified risks*" (IFSB, 2018 January). Therefore, *Takaful*, regardless of how it is interpreted in other languages, is a *Shari'ah*-compliant mutual assurance contractual structure, where participants contribute their resources to mitigate against future risks based on agreed terms.

Misconceptions on *Takaful*

Even though the practice of *Takaful* insurance is widely approved by the majority of contemporary Muslim scholars, there is still some confusion, debates and disputes about its permissibility and *Shari'ah* compatibility

The misconceptions and relevant clarification on each of them are summarised as follows:

1. ***It is claimed that Takaful* contains an element of usury (*riba)* as it involves an exchange of money for money with an additional amount**. However, *Takaful* does not involve *riba* as it is practised based on the principle of *tabarru'* in which the participants pay contributions as a donation for their mutual benefits. When a member suffers loss, the compensation paid to him is not *riba* because it is not a consideration of his *Takaful* contribution; but it is a donation from other participants.
2. **It is claimed that *Takaful* also contains an element of uncertainty (gharar). It is argued that the subject matter in the *Takaful* contract is the compensation to be paid on the occurrence of insured events such as death, accident or injury which is presumed to occur in the future that is uncertain; hence, this kind of transaction is prohibited by the *Shari'ah*.** However, this perception is wrong since *Takaful* is a *tabarru'* (donation) contract in which uncertainty of the subject matter is tolerated. In contrast, in the contract of insurance, which is a sale-based transaction, the subject matter must be specified for such a transaction to be valid.
3. ***It is claimed that Takaful is also said to involve an element of maysir (gambling), as the policyholder pays a certain amount of contributions in the hope of better returns. It is argued that maysir comes into existence when the sum paid out by the Takaful company exceeds what the policyholder had already paid in terms of Takaful contributions in the event where the policyholder dies during the earlier period of the contract. It could also be because the Takaful benefit is paid together with bonuses and dividends.*** However, the above contention is incorrect because the payment to the policyholder (in the case of early death or early termination) is from the collective contributions provided by other policyholders based on the concept of

tabarru'. The *Takaful* concept deals with pure risk and not speculative risk. Thus, *maysir* cannot be associated with *Takaful* since the element of risks that exists in *maysir* is not a pure risk but creates new, unnecessary speculative risks. It is also wrong to claim that there is an element of *maysir* because the aim of gambling is gaining material wealth while defeating other gamblers. *Takaful,* in contrast, is meant for mutual cooperation and assisting one another (*ta'awun*). It is mutual assistance to orphans, widows, other dependants as well as one's self against unexpected future loss, damage or perils.

4. ***It is claimed that Takaful is contrary to the principle of tawakkul (reliance on God or trusting in God's plan). This misconception is based on the fact that the policyholder puts trust on the Takaful company to protect him against an unanticipated loss instead of putting the trust in Allah the Almighty and this is in contradiction with the principle of tawakkul as we can only put our trust in Allah the Almighty***. The claim can be rebutted by understanding the real concept of *tawakkul* whereby one does his best to protect the risk and afterwards hopes for the best by putting his trust in God and with God's blessings. The reason is that *Takaful* is used as a financial tool to provide indemnification or financial benefits on the occurrence of loss to reduce the financial burden suffered by the policyholder. It could be considered as an initiative or effort to the best of the policyholder's ability to overcome future unexpected difficulties. Also, based on the *tawakkul* concept, one is asked to strive for his best before putting his trust in Allah the Almighty.

5. ***It is claimed that Takaful means to insure one's life against death or to insure one's wealth and property. This is against Allah's will on the ground that no one can insure one's life or death except Allah. Thus, the practice of Takaful is unlawful. It was further argued that insuring or protecting wealth is only allowed in three situations; fear for unjust enrichment, fear of losing the property and fear of property being destroyed. However, in Takaful, the protection is given regardless of the presence of the above three situations.*** This argument seems to be groundless based on the reason that the *Takaful* certificate does not overpower Allah's will. *Takaful*'s aim is not to determine one's life or death but to ensure that the policyholder gets financial benefits from the *Takaful* fund on the occurrence of any unexpected loss or damage. Such transaction is in accordance with the *Shari'ah* principle as Islam encourages the people to do their best in protecting themselves from any difficulties and help one another.

6. ***It is claimed that Takaful also contains unlawful elements or conditions.*** A contract which is based on impermissible elements is not valid as the Prophet (PBUH) mentioned in a Hadith (Jami' al-Tirmizi, Vol.3 Book of Judgement, Hadith 1352): "*Muslims are bound by their stipulation or conditions except for the conditions that prohibit the lawful or the conditions that permit the unlawful*".

On the contrary, it is to be noted that Takaful does not contain unlawful conditions. It is based on such lawful contracts as *tabarru'*, *mudarabah* (trust partnership contract) and *wakalah* (agency contract). However, all terms and conditions in the contracts must be *Shari'ah*-compliant or, otherwise, *Takaful* contract is not valid.

In a nutshell, the above misconceptions arose as a result of the lack of understanding about the genuine concept of *Takaful* which is an arrangement of mutual assistance aiming to assist orphans, widows, other dependents as well as the policyholder himself against unexpected future loss, damage or peril.

2.1.2. Significance of Insurance and *Takaful*

Risk is the probability of two outcomes, and the ultimate outcome is usually unknown. Others see risk as the probability of loss in an event. Risk is an integral part of life as every human endeavour, particularly in business activities, entail risk. It is typically attributed to uncertain events in the future such as accidents, death, thefts, fire, diseases, and disasters, among others, that may result in losses, damage and financial difficulties. From time immemorial, people continue to develop measures and tools to manage risks. In modern times, such tools are primarily in the form of insurance, which has become indispensable for individuals and businesses to mitigate and manage risks that otherwise could result in losses and adversely affect people's lives and their wealth.

The insurance industry today has become an essential component of business and financial eco-system. The insurance business is largely operated by non-banking institutions. Nevertheless, both the banking and non-banking financial institutions have to conform to the insurance regulatory requirements and guidelines to provide their services. Individuals, businesses and governments have been increasingly using insurance services to manage risks against unforeseeable incidents and losses to life and wealth.

The rapid development of Islamic finance has necessitated the need for *Shari'ah*-compliant alternative to conventional. This alternative, which is based on *Shari'ah* principles may also be referred to as "Islamic insurance". *Takaful* operates in line with *Shari'ah* principles and, at the same time, offers the benefits and services equivalent to its conventional counterpart. Therefore, *Takaful* has evolved in response to the ever-increasing yearning of faith-based financial consumers for an insurance system fulfils their religious beliefs and provides the desired risk coverage for individuals and IFIs. The Islamic banking, capital market and insurance have complemented one another in the *Shari'ah*-compliant eco-system. The *Takaful* industry now includes small, medium and large firms. The industry has rapidly developed in such a short period globally in both Muslim and non-Muslim countries. This growth has far-reaching positive implications for individuals and businesses patronising *Takaful* and abandoning conventional insurance for reasons related to both business and belief. Beyond the religious principles underpinning it, the *Takaful* theoretical model is fundamentally based on mutual benefits and cooperation.

The first modern *Takaful* was established in Sudan in 1979 (Archer et al., 2009: pp.1-2), which was developed by Professor Al-Sideeq Al-Dareer - a prominent Sudanese *Shari'ah* scholar. After participating in many seminars and conferences, he came up with the idea of insurance that is cooperative and mutual by nature rather than commercial. He suggested "*the adoption of a mutual structure for underwriting insured risks, whereby the insureds (participants) mutually insure one another, on a non-profit basis, according to the principle of Takaful (the Arabic word for ''solidarity'')*". To do this, he suggested a solution that treats the policy contributions (premiums) as a *conditional and irrevocable tabarru'* (donation). The insured participants in this model, are at the same time both insurers and insured and share all the fortunes and misfortunes of the fund. (Archer et al., 2009).

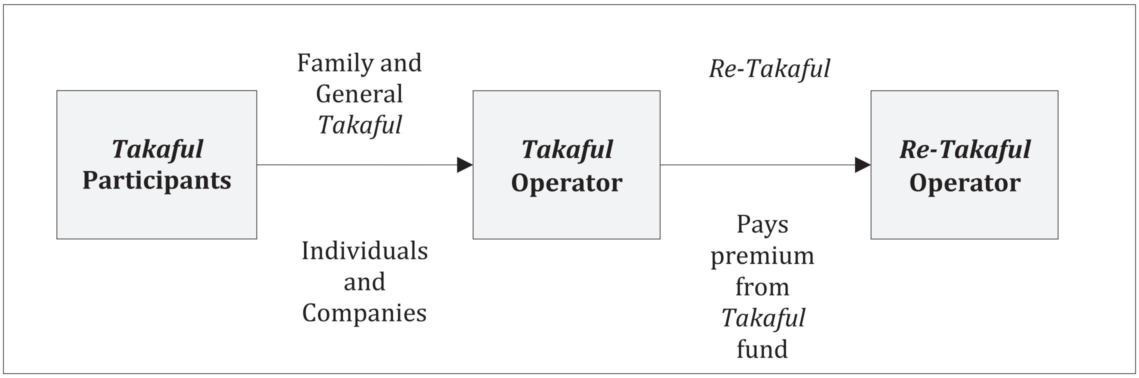
2.1.3. *Re-Takaful*

Takaful cannot be discussed in isolation without exploring all its aspects. To support *Takaful* business activities and mitigate risks, *Re-Takaful* is an important extension of *Takaful*. This section defines the theoretical and practical aspects of *Re-Takaful* and provides a summary from the *Shari'ah* perspective.

Re-Takaful is defined as the "*Takaful* for the *Takaful* operators". It is a way for a primary *Takaful* operator (TO) to protect itself against unforeseen or extraordinary losses. The TO pays a premium from the *Takaful* fund on behalf of the participants to the *Re-Takaful* company, and in return, the *Re-Takaful* operator (RTO) provides security for the risk sharing. The need for TOs to engage RTO as a means of risk sharing is undoubtedly consistent with the concept of risk mitigation underlying the concept of *Takaful* and *Re-Takaful*. The *Re-Takaful* arrangement helps the TO to transfer some or selected risks to ensure the viability of its business and, most importantly, to ensure that all the policyholders are protected.

Takaful and *Re-Takaful* are like Siamese twins that are highly dependent on each other. *Re-Takaful* functions as the primary risk-mitigating tool for the TOs in the form of providing a balance of the portfolios of the TOs, assisting them in attaining the homogeneous risks, avoiding unnecessary exposures of the TO's portfolio and strengthening of capital for TO as required by domestic laws or regulations. *Re-Takaful* mainly involves two parties to its contract – that is, the TO, which is also known as a ceding company, and the RTO. The TO needs to limit the risks undertaken from the *Takaful* participants by ceding it to the RTO that assumes a portion of the risk transferred by the TO.

FIGURE 2: *RE-TAKAFUL* CONCEPT



Source: Authors

While the TO is the primary *Takaful* provider for the people and corporations, the RTO exists in the secondary *Takaful* market with a direct function to accept cessations of risks based on its contractual obligations. As illustrated in *Figure 2* above, the participants of *Re-Takaful* are the TO instead of individual or group participants. This arrangement is required because the TO needs to share the risks (undertaken from individuals and group participant) with the *Re-Takaful* operator. Just as the TO does to the *Takaful* participants, the RTO also assumes the responsibility of managing and investing the premiums of the TO.

Types of Re-Takaful

In the *Takaful* industry, a TO reduces its risk of paying a large number of claims by sharing its risk with another company. This other company is RTO. This arrangement supports the TO in situations of high claims, such as in the case of natural calamities, fires, riots, and other major disasters that significantly affect many policyholders at once. In such unforeseen situations, a TO may not be able to cover the entire risk of covering the claims of its participants.

Consequently, the *Takaful* fund may be depleted, in which case the participants, the shareholders, and the TO will suffer significant losses. Splitting and sharing the risk with an RTO through a *Re-Takaful* arrangement enables the TO to manage the company better through such difficult periods. Therefore, *Re-Takaful* is a practical arrangement to ensure the stability of not only the TOs but also the entire Islamic finance industry.

Re-Takaful operates a similar way that *Takaful* does. The only difference is that while the participants or policyholders of regular *Takaful* products are individuals, businesses, and other commercial organisations; the *Re-Takaful's* participants or policyholders are the TOs. The fund operator is the RTO that operate its business and activities according to the principles as required by *Shari'ah* and the domestic laws or regulations.

The contracting parties who sign the *Re-Takaful* contract are the TO and the RTOs. The original policyholders of the *Takaful* products are not directly involved in the *Re-Takaful* contract, and they are not privy to same. The contributions or premiums paid by the TOs to the RTO are managed and invested based on the specific *Shari'ah* contracts such as *wakalah* (agency contract), *mudarabah* (profit sharing partnership contract), or *wakalah-mudarabah* hybrid arrangements. The earnings (profits and fees) are shared between the TOs and RTOs based on pre-agreed terms.

If a TO becomes insolvent because of unanticipated claims arising from its participants, the RTO guarantees that it will provide a *qard hasan* (interest-free loan) to cover the liability. The loan must be repaid in the following periods based on specified terms or is deducted from any *Re-Takaful* surplus belonging to the TO in the following year (Jamaldeen, n.d.).

Re-Takaful can be in the form of facultative and treaty. Facultative *Re-Takaful* is "*a Re-Takaful contract under which a ceding TO has the option to cede, and the RTO has the option to accept or decline individual risks*" (MTA, 2018). It is offered and accepted on a case by case basis, and it is not necessary for both TO and RTO company to enter into a specific arrangement. Under the facultative arrangement, each underwritten policy is considered a single transaction, not lumped together by class. The RTO chooses or performs its underwriting for some or all the policies to be subscribed under the *Re-Takaful* arrangement. As such, facultative *Re-Takaful* is usually the simplest way for a TO to obtain *Re-Takaful* protection since it is easy to tailor to specific circumstances.

On the other hand, treaty *Re-Takaful* occurs when the ceding company cedes all risks within a specific class of *Takaful* policies to the RTO without having to perform individual underwriting for each or all policies. In turn, the RTO agrees to indemnify the ceding company of all risks under the arrangement. This structure is typically governed by a standing agreement or contract on an annual basis. In this model, the RTO has the responsibility to bear all the risks within the scope of the agreement.

There are two types of treaty arrangements: proportional and non-proportional treaties. In the *proportional treaty*, both TO and RTO participate proportionately in the contributions and losses on every risk that comes within the ambit of the agreement. Under this arrangement, there is a quota share and a surplus. A quota share is a basic form of participating treaty whereby the *Re-Takaful* accepts a stated percentage of every risk within a specified category of business on a pro-rata basis. It is to be noted that participation in each risk is fixed and certain, and the surplus is the excess of assets over liabilities. The statutory surplus is the *Takaful* or *Re-Takaful* capital as determined under statutory accounting rules. Surplus determines the *Takaful* or *Re-Takaful* capacity to underwrite businesses. In contrast, in the *non-proportional treaty*, the ceding TO agrees to accept all losses up to a threshold. The RTO agrees to reimburse the ceding TO for losses above the threshold and up to the reimbursement limit determined in the contact.

2.2. *Shari'ah* Principles of *Takaful* and *Re-Takaful*

This section discusses the various views, interpretations and thoughts of Muslim jurists based on their interpretation of *Shari'ah* principles underpinning *Takaful* and *Re-Takaful* businesses, and their similarities and differences from the conventional insurance.

Takaful as a concept has its root, reflected in many forms, in the Muslim society since its inception. Nevertheless, the legality of the current *Takaful* practice is viewed by contemporary *Shari'ah* scholars from three different perspectives. These differences in the legality of the *Takaful* practice arise from the way the scholars have classified the insurance contract. Some scholars consider *Takaful* as cooperation and donation contract while others classify it as an exchange contract.

Scholars who view *Takaful* as an exchange contract are further divided into two groups. The first group prohibits in general all types of insurance, whether it is Islamic or conventional, due to the nature of exchange contract used in such transaction. *Takaful* in an exchange contract would entail *gharar* (contractual uncertainty) that is prohibited by the *Shari'ah*. The second group takes the opposite view in legalising all types of insurance, including the commercial/ conventional insurance based on an exchange contract. This view is supported by Sheikh Mustafa Zarqa who was the first to write on the legality of conventional insurance from the *Shari'ah* point of view (Zarqa, 1984).

Meanwhile, scholars who view *Takaful* or insurance as a contract of cooperation and donation, deem it permissible under the *Shari'ah*. This is the most dominant view among scholars and upon which the modern *Takaful* industry is based. This view is represented by the central bodies of *fatwa*[6] in the Muslim world such as the IIFA, AAOIFI, the Islamic Research Academy of Al-Azhar Al-Sharif, and Islamic Fiqh Academy of the Muslim World League as well as the Council of Eminent *Shari'ah* Scholars of the Kingdom of Saudi Arabia. Below are excerpts of the resolutions of the bodies as mentioned above;

The first resolution issued on the matter was in 1985, by the IIFA in its second session where it distinguished between Commercial and Cooperative insurance. It prohibited the former and permitted the latter. The IIFA resolved (Mikail & Tijani, 2014) thus:

> "***First:*** *The commercial insurance contract with a fixed periodical premium, which is commonly used by commercial insurance companies, is a contract which contains major elements of deceit, which void the contract and, therefore is prohibited (haram) according to the Shari'ah.*
>
> ***Second:*** *The alternative contract, which conforms to the principles of Islamic dealings is the contract of cooperative insurance, which is founded based on charity and cooperation.*

[6] A response given by a qualified Muslim scholar (*Mufti*) to a particular issue in particular circumstances.

> *Similarly, it is the case of reinsurance based on the principle of cooperative insurance.*
>
> ***Third:** The Academy invites the Islamic countries to work on establishing cooperative insurance institutions and cooperative entities for reinsurance to liberate the Islamic economy from exploitation and put an end to the violation of the system which Allah has chosen for this Ummah*."

Later in 2005, the same body, i.e. IIFA, permitted Health Insurance with some conditions to be observed. The following is its relevant resolution on this issue:

> " *1. If the Health insurance contract is concluded directly with the hospital, it is permissible. However, specific guidelines must be observed, such as ensuring that the ambiguities or gharar is minimized, and the need for Health insurance is apparent that it can be considered as a daruriyyat (necessities) matter, because of its connection with the protection of life, intellect and offspring, which form part of the five essentials that the Shari'ah seeks to preserve. Apart from that, several conditions must be fulfilled, as follows:*
>
> *a. The responsibilities of the contracting parties must be comprehensively defined;*
> *b. A study on the health condition of the insured, as well as his probable future health conditions, must be conducted; and*
> *c. The contractual relationship between the organisation seeking insurance and the health institution must be direct, and no conventional insurance company is involved, so that all medical bills are forwarded straight to the said organisation.*
>
> *2. If the Health insurance is from an Islamic insurance company (Takaful or ta'awun - mutual assistance), which manages its activities in line with the guidelines of the Shari'ah, which the Council have recognised in its Resolution no. 9(2/9) regarding insurance and reinsurance, it is permissible; and*
>
> *3. If Health insurance is provided by a conventional insurance company, it is not permissible, as clearly mentioned in the above resolution.*"

The above two resolutions were confirmed and consolidated in resolution No.200 by IIFA in 2013, where the council addressed in detail all the relevant technical and *Shari'ah* matters relating to insurance and *Takaful*.

The AAOIFI issued a *Shari'ah* Standard on Islamic insurance in 2006 serving as a guideline for regulators and industry players for establishing Islamic Insurance institutions in compliance with the *Shari'ah* (AAOIFI, 2019).

Specifically, the importance of *Shari'ah* in regulating RTOs has been emphasised by Muslim scholars since 1985. A resolution was passed by Islamic Fiqh Academy on the need for a proper set up of *Takaful* or *Re-Takaful* operation to replace the conventional insurance and reinsurance that is prohibited due to the existence of *riba*, *gharar* and *maysir*. The resolution also indicated that the *Takaful* and *Re-Takaful* activities must be supervised by a permanent *Shari'ah* Advisory Board. Such *Takaful* and *Re-Takaful* operators are to adopt investment strategies which comply with the *Shari'ah* and ensure they operate by utilizing modes of financing that are in line with the *Shari'ah* principles and concepts (Benbouzid, 2005).

Since the early 1980s, there have been a lot of efforts and initiatives to develop the *Re-Takaful* operations and models that are *Shari'ah*-compliant and distinguishable from the conventional reinsurance practices that are tainted with prohibited elements of *riba*, *gharar* and *maysir*. The *Shari'ah*-compliant operations have been introduced to replace the traces of all the three prohibited elements (*riba*, *gharar* and *maysir)* that are substantially unavoidable in reinsurance. The practice of conventional reinsurance involves *riba* in the contract between a cedant and a reinsurer. This is questionable from the *Shari'ah* perspective because the ceded premiums being invested by the reinsurer in financial instruments may contain elements of *riba*. The commission in *Re-Takaful*, in contrast, does not depend on the investment of profit, but it is based on the agreed *wakalah* fee for the services rendered by the *Re-Takaful* company. In addition, the investment activities in *Takaful* and *Re-Takaful* are conducted in a *Shari'ah*-compliant manner and free from any prohibited elements.

Gharar and *maysir* relate with the element of ambiguity and gambling that must be eliminated from a contract of sale whose existence and description of the items are not confirmed or where there is asymmetric information leading to deception (El-Gamal, 2001). In a conventional reinsurance contract, the reinsurer's gain or profit is made from the premiums paid. In this case, the beneficiary may not gain any profit, if there was no claim made during the contract period; and thus, the element of uncertainty exists (Zuhayli, 1997). Distinctively, the *Takaful* and *Re-Takaful* operations that are developed based on the concept of cooperation (*tabarru'* or *ta'awun*) eliminate *gharar* and *maysir*. The operation of *Re-Takaful* is, in fact, a cooperative exercise in which the TO contributes towards a pool of fund. The claims are then made from the fund and, then, in case of underwriting surplus, all unclaimed profits (surpluses) are shared with the TOs (Yusuf & Yuhasni, 2011).

Permissibility or Legality of *Takaful*

There is no direct legal text in the Holy Qur'an and/or the Sunnah on the permissibility or non-permissibility of *Takaful*, but there are many legal texts in the Qur'an and prophetic precedents (*hadith*) that encourage the spirit of *Takaful* which is based on cooperation, shared responsibility, joint indemnity, common interest and solidarity. Allah the Almighty said:

> "*And help ye one another in righteousness and piety but help ye not one another in sin and rancour, and fear Allah for Allah is strict in punishment*" (Qur'an, Surah al-Maidah, 5:2)

Furthermore, the Prophet (PBUH) also advised the Muslims to help one another to relieve hardships, as narrated by Salim (r.a.):

> *"And he who relieved a Muslim from hardship Allah would relieve him from the hardships to which he would be put on the Day of Resurrection…"* (Sahih Muslim, *Kitab al-Birr wa al-silah wa al adab*).

On other occasions, the Prophet (PBUH) also mentioned that we should leave our offspring and dependants wealthy than to leave them destitute, hoping for other's help. Saad bin Abi Waqqas (r.a.) narrated that the Prophet (PBUH) said:

> *"Verily it is better for you to leave your offspring wealthy than to leave them poor asking others for help"* (Sahih Bukhari, Kitab al-Faraidh, Vol. 8, Book 80, no. 725).

Referring to the contexts of the above Qur'anic verse and prophetic precedents, Muslims are encouraged to share the responsibilities in alleviating hardship and difficulties among others as this is a social responsibility. Besides, the above legal texts promote the concept of mutual co-operation as being introduced under the *Takaful* principle.

In addition to the above injunctions, the legality of *Takaful* could also be supported with analogies (*qiyas*) with several practices in Islamic law which is similar to it. These practices are the concept of *'aqilah* (paternal relatives' responsibility) in the payment of *diyah* (blood-money in the case of unintentional murder), the payment of *fidyah* (ransom of prisoners of war), the concept of *nahd/nihd* (sharing of food among members of a group) and *waqf* (Islamic charitable endowment). The application of the concept of '*aqilah* in the payment of blood money in case of murder was a customary practise among ancient Arabs whereby members of the offender's tribe shared the cost of blood-money payable to the family of the victim. This has some similarities with the concept of *Takaful*. In both practices, the burden of loss is shared proportionately among the members of a group. The contributions made by the participants to the *Takaful* fund may also be equated with the contributions for *diyah* by the *'aqilah* because both are made based on *tabarru'* to cover the loss. However, the only difference is that the contributions for *diyah* are made after the loss, whereas in *Takaful* the contributions are made in advance. Apart from that, the *diyah* paid to the victim or his/her family could be considered similar to the compensation paid to the *Takaful* participant or his/her beneficiaries.

Similar to *diyah*, the payment of *fidyah* was also practised by the Arabs since the pre-Islamic period. When a tribe was defeated by another in a war, the prisoners of war became slaves of the victor. The '*aqilah* or members of the prisoners' tribe shared the responsibility to pay the ransoms to the winning tribe to release their kinsmen. This collective mechanism, which could be considered as an old system of social insurance, was adopted and adapted by the Prophet (PBUH) during his time for the same purpose.

Another concept that embodies the elements of cooperation and mutual help is *al-nahd* or *nihd,* which refers to the contributions made by a group of people for their expenses according to their number. This term is normally used for the contribution of food and drink. It is explicitly mentioned by Al-Bukhari in relation to the practice of the Companions of the Prophet (PBUH) whereby they collected and shared their food during their journey or due to the shortage of food supplies. This practice is acknowledged by the Prophet (PBUH), as evident in several hadith, one of which is translated as follows:

"*When the people of Ash'ari tribe ran short of food during the holy battles, or the food of their families in Medina ran short, they would collect all their remaining food in one sheet and then distribute it among themselves equally by measuring it with a bowl. So, these people are from me, and I am from them*." (Sahih Bukhari, Kitab al-Faraidh, Vol. 8, Book 80, no. 725).

The sharing of resources in *nihd* may be analogous to the contribution to the *Takaful* fund. Another similarity between *nihd* and *Takaful* is that the amount of food or compensation that is given to the recipient is not equal to the amount of his/her contribution. However, the difference between the amount of contribution and the amount of benefit is not *riba* because the objective of *nihd* and *Takaful* is for charity and cooperation.

Finally, the concept and institution of *waqf* also provide support for the idea of mutual help. *Waqf* refers to Islamic charitable endowment in which a property is given away for the benefit of the public or specific beneficiaries by freezing its corpus from being transferred to others while its usufruct is dedicated permanently to the recipients. *Waqf* has been established in Muslim communities for different purposes, which are determined by the founder (*waqif*). Even though the *waqif* permanently loses his ownership over the *waqf* property according to the majority of the Muslim jurists, he could still share some of its benefits with the beneficiaries. This feature makes *waqf* seem to be an appropriate basis for the application of *Takaful*.

The above illustrations support the general concept of *Takaful* to mutually compensate the losses suffered by a member of a group or society. *Takaful* conforms to the Islamic principles on the protection of public interest (*maslahah*). *Takaful* embodies the elements of cooperation, mutual indemnity and shared responsibility, which are promoted by the *Shari'ah* and supported by several related practices mentioned above. Since *Takaful* also shares some similarities with these practices which are approved by Islamic law, the same recognition should be given to *Takaful*.

2.3. Comparison of *Takaful* with Conventional Insurance

This section presents a comparative analysis of the *Takaful* insurance in comparison with conventional insurance, emphasising on the concepts, features and nature of risks. The concept of *Takaful* is quite like cooperative insurance (called *ta'min ta'awuni*) where the participants mutually agree to help one another. The participants undertake to contribute a certain amount of money as *tabarru'* (donation) to the *Takaful* fund, and they are also entitled to receive *Takaful* benefits payable from the fund on the occurrence of certain events covered under the scheme. Therefore, under a *Takaful* arrangement, the *Takaful* participants play in the same time the roles of insured (policyholders) and the insurer (*Takaful* benefits provider). Unlike the conventional insurance companies which undertake to provide compensation to the policyholders, the TO's duty is only to manage the *Takaful* fund and administer *Takaful* certificates (policies) adequately.

Thus, the main features of *Takaful* can be summarised as follows:

- Policyholders (*Takaful* participants) jointly protect their common interest.
- The participants pay their contributions to assist those of them who need assistance.
- The payment of *Takaful* contributions is made based on *tabarru'* to share the burden of losses and spread liability as per the community pooling system.
- Based on the contract of *tabarru'*, the element of uncertainty in the payment of contribution and compensation is tolerated.
- *Takaful* is not aimed at taking the advantage at the cost of others.
- The *Takaful* company is not an insurer which is obliged to pay indemnification or *Takaful* benefits to the participants, but it is only a manager or administrator responsible for managing the fund and administering its operations.

As discussed above, there are debatable issues among Muslim jurists about the concept of insurance. This makes a case for the need to examine the differences between *Takaful* and conventional insurance based on a number of themes. *Table 3* below provides a snapshot of the differences between *Takaful* and conventional insurance.

TABLE 3: *TAKAFUL* VS CONVENTIONAL INSURANCE

Themes	Conventional Insurance	*Takaful*
Concept	Based on the Contract of Bottomry	Based on *Aqilah*
Principle	The Contract of *Bottomry* was founded on interest	*Aqilah* was practised based on cooperation among the tribes
Contractual relationship	• Interest-based contract • Bilateral contract	• *Shari'ah*-compliant *Takaful* models • Multilateral contract
Motive	Profit based	Mutual help and *tabarru'*

Themes	**Conventional Insurance**	***Takaful***
Payment	Premium belongs to the insurance companies	Contribution belongs to the participants and TOs, depending on the *Takaful* model adopted
Standard-setting bodies	IAIS, Local standard-setting bodies	AAOIFI, IFSB, Local standard-setting bodies
Choice of investment	No restriction	*Shari'ah*-compliant investment
Risk mitigation approach	Risk transfer	Risk sharing
Method of managing risks	Risks are transferred from the insured to the insurer.	Risks are distributed to the whole group of participants, and the burden of losses is shared equitably among them
Surplus from participant risk fund	It belongs to the insurance company	It can be shared depending on the *Takaful* models adopted
Profit motive	Commercial insurance companies make profits for their shareholders by protecting the policyholders against risks in return of fixed premiums	*Takaful* companies make profits for their shareholders by managing and investing the *Takaful* fund on behalf of the participants. *Takaful* coverage against risks is provided by the participants on a mutual or cooperative basis
Profit from investment	It belongs to the insurance company only	It can be shared between participants and TOs according to the *Takaful* model adopted
The nature of the contract	The contract of commercial insurance is a sale and purchase of insurance policy between the insurer and the insured	*Takaful* is a contract of *ta'awun* which combines the elements of *musharakah* and *tabarruʿ*. The contract of *muʻawadah* only relates to the management of the *Takaful* funds
The obligation of the parties of the contract	The policyholder is obliged to pay the premiums while the insurer is obliged to pay the compensation to the policyholder upon the occurrence of losses specified in the policy	The participant is obliged to pay the contributions as a commitment to provide indemnity to other participants on a mutual basis while the TO is obliged to manage and invest the *Takaful* contributions
The ownership of insurance/*Takaful*	The paid premiums, together with all the investment	The *Takaful* contributions, profits from their investment and the

Themes	**Conventional Insurance**	***Takaful***
fund	profits and underwriting surplus, belong to the insurance company	surplus belong to the participants collectively
Receivable upon maturity	The amount agreed upon in the contract (dividends, bonus, and interest)	Participant's share from the investment account and profit (if any) from investment and the maturity value of the participant's risk fund
Receivable upon surrender	The amount agreed upon in the contract (interest, dividend and bonus (if any)	Participant's share from the investment account and profit (if any) and the surrender value of the participant's risk fund
Liability to pay claims	The company is liable to pay the claims from its assets (the insurance funds and the shareholders' fund) even though the claims exceed the amount of the paid premium.	All claims are paid from the *Takaful* fund. If the number of claims exceeds the amount collected in the fund, the participants should increase their contributions
Investment of the insurance/*Takaful* fund	The premiums might be invested in interest-bearing securities	The funds must be invested in *Shari'ah*-compliant instruments and *halal* businesses
Sources of ruling	Purely based on "man-made" laws such as Acts, Case laws and age-long trade practices	Qur'an, Sunnah, and Fiqh rulings based on revelations
Agency commission	Paid from the premium	Depending on the *Takaful* model adopted

Source: Rusni Hassan, 2011

CHAPTER 3: TAKAFUL BUSINESS MODELS

This chapter examines the various *Takaful* business models used in the Islamic finance industry with certain noticeable variations across different jurisdictions. It also examines the types of *Takaful* structures utilized that have some implications for the way they are established, managed and accept contributions. This is reflected in the different contractual relationships established in the different models identified.

The discussion on the business models of *Takaful* involves the analysis of the existing practices of the *Takaful* industry and its business models. It discusses the operational models adopted by *Takaful* companies, including the various *Takaful* structures in the market. It also provides diagrams and charts to analyse the structures and working mechanisms, considering the similarities and differences of each. More importantly, it provides charts for each model, clarifies the flow of contributions, and distinguishes between General and Family *Takaful* once each *Takaful* structure model is reviewed.

3.1. Underlying Contracts in *Takaful*

One of the fundamental differences between conventional insurance and *Takaful* is the underlying contract. A conventional insurance contract is a contract of exchange, whereby an insurance company (insurer) promises to provide insurance coverage or protection against certain losses, in consideration of the insurance premiums paid by the policyholder (insured). Under the insurance contract, there is no element of cooperation and mutual protection between the insurer and the insured parties collectively, because the former makes a profit by providing insurance coverage for a predetermined premium paid by the latter.

On the other hand, in a *Takaful* scheme, the *Takaful* participants are simultaneously the insurer and insured. They collectively contribute to a *Takaful* fund which will be used to pay claims to any of them who incurs certain losses. Their contributions do not derive advantage at the cost of others but ensure mutual financial protection or indemnity among themselves. Unlike the conventional insurance company, a *Takaful* company is not an insurer which takes liability to insure the participants in consideration of the *Takaful* contributions paid by the participants. However, the former only manages and invests the *Takaful* funds on behalf of the latter. Therefore, there are two types of the contractual relationship in the *Takaful* arrangement:

a) the contractual relationship among the group of participants, and
b) the contractual relationship between the group of participants and the TO.

3.1.1. The Contractual Relationship among the Participants

The first scenario is the *Takaful* relationship, which is established between the participants themselves, based on cooperation and solidarity, whereby they contribute their money to provide the financial assistance to any of them, who suffers a loss covered under their *Takaful* policy. Under this relationship, the participants agree to insure each other against loss on a reciprocal basis. The contract of *tabarru'* is used as the underlying contract to govern the relationship among the participants. Under this contract, every participant agrees to renounce a certain amount of the contribution that he or she pays to a *Takaful* fund, as a donation, in order to provide the mutual indemnity to any fellow participant who suffers from a defined loss. By way of donation, the issue of *gharar* which exists in commercial insurance from the exchange of an uncertain amount of loss for a fixed amount of premium could be avoided because the compensation or *Takaful* benefit received by the participant in the event of a loss is not a reward (*'iwad*) for his contribution; instead, it is a donation provided by the other participants to ease his or her burden. Though the amount of compensation is uncertain at the time of the contract because it depends on the actual loss, this uncertainty does not affect the contract of *Takaful* because *gharar* is tolerated in donation-based contracts.

However, it should be noted that the contract of *tabarru'* in *Takaful* is not a pure donation contract like *sadaqah* or *hibah* (gift). It could be considered as a conditional donation because, in the contract of *Takaful*, every participant donates to the *Takaful* fund so that it could be used to help fellow participants on the condition that he will be indemnified by the fund (or by other participants) if he suffers the loss covered under the *Takaful* policy. This type of *tabarru'* is quite similar to the concept of *nihd,* which was approved by the Prophet Muhammad (PBUH).

3.1.2. The Contractual Relationship between the Participants and the TO

The other scenario within the *Takaful* contractual arrangement is the relationship between the participants collectively and the TO. It should be noted that this relationship is not established to provide *Takaful* coverage, but it is for the management and investment of the *Takaful* fund. The TO is appointed by the participants to manage and invest the *Takaful* fund for them. In general, the TO is responsible:

a) to manage the *Takaful* scheme, which mainly involves the underwriting process to determine the amount of *Takaful* contributions and sum covered, to process claims and pay the *Takaful* benefits to the participants. These tasks are known as management of underwriting activities.
b) to manage the investment portfolio of the *Takaful* fund in line with *Shari'ah* principles.

Contrary to the first relationship, the latter relationship is usually formed on a commercial basis because the TO is a commercial company. Hence, TO may charge fees for its services and/or shares some of the investment profits depending on the type of contracts that governs the relationship between the company and the participants. Several types of contracts could be used to govern the relationship between the participants and the TO. Firstly, this relationship may be established using the contract of *mudarabah*. Under this contract, the participants, collectively as the capital providers, entrust the TO, as the *mudarib*, to invest the *Takaful* contributions to generate profits for the *Takaful* fund. Any profits from the investment will be shared between the *Takaful* fund (participants' portion) and the TO at a pre-agreed ratio.

Secondly, the contract of *wakalah* could also be used to govern this relationship. Under the *wakalah* model, the participants as the principals (*muwakkil*) appoint the TO as an agent (*wakil*) to perform the specific tasks of managing and investing the *Takaful* fund on their behalf. The contract of *wakalah* is very flexible; it could be applied for delegating either the management of underwriting activities or investment of the *Takaful* fund or for both. As an agent who works on a commercial basis, the company normally charges fees (*ujrah*) for their services. The amount or rate of the fees must be fixed and agreed by the TO and the participant upfront.

Thirdly, the contract of *ju'alah*[7] (reward) could also be used to govern the relationship between the TO and the participants. In this contract, the participants appoint the TO to manage the *Takaful* fund to reach a certain level of performance, and a specific amount of reward or commission will be paid to the TO if the required outcome is achieved. Under this arrangement, the payment of reward or commission to the TO depends on the final result at the end of the financial year. If the TO does not achieve the required outcome, it would not be entitled to get the reward. In the operation of *Takaful*, the contract of *ju'alah* is typically used for the payment of performance fee to the TO. The fee is paid as an incentive to the TO if there is a surplus in the risk fund after deducting claims and expenses.

Finally, the relationship between the TO and the participants could also be governed by a combination of two or all of the above-mentioned contracts. For example, the contract of *wakalah* could be used for the management of the *Takaful* fund and the contract of *mudarabah* used for the investment of the fund. Through this arrangement, the company charges a fixed fee for the management of the fund and shares some portions of the investment profits with the participants. Also, the contract of *ju'alah* could be added to provide incentives for the TO if it could improve its performance to achieve specific outcomes.

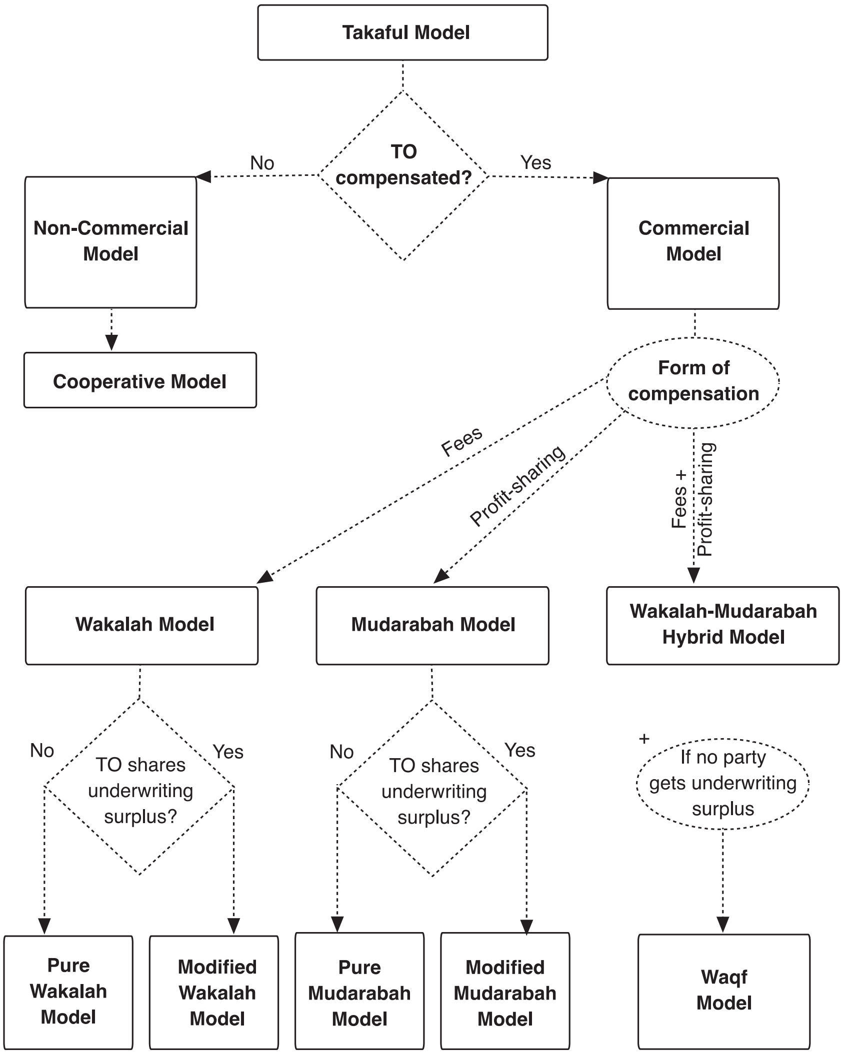
3.2. *Takaful* Modus Operandi

The *Takaful* industry has developed significantly over the years and with the help of *Shari'ah* scholars some of whom are members of *Shari'ah* Boards, several *Takaful* models (non-commercial and commercial models) have been developed. *Figure 3* classifies the models according to the underlying contract, which clarifies how the TO is compensated for the management of the *Takaful* fund. From the regulatory perspective, a major concern is how the TO is compensated for its services. Every *Takaful* model defines the following aspects:

[7] It is a contract of reward, a unilateral commitment to reward for a specific act or accomplishment.

- Relationship between the Participants and TO,
- Rights and obligations of the Participants and TO,
- Who pays the expenses incurred during the contract period?
- How is surplus distributed between the parties? and
- Who is liable for the losses arising from the *Takaful* business?

FIGURE 3: CLASSIFICATION OF *TAKAFUL* BUSINESS MODELS



Source: Authors' own

3.2.1. *Ta'awuni* (Cooperative) Model

This model is a non-commercial arrangement based on the concept of brotherhood, solidarity and cooperation among the participants, to protect each other in case of misfortune or calamity befalling any of the participants. The Trustee (the *Takaful* company) manages it on behalf of the participants. The contributions by each participant to the *Takaful* fund takes the form of *tabarru'*. The entire profit from the *Shari'ah*-compliant investment, as well as any underwriting surplus, belong to the participants only. In modern times, this model was first implemented in Sudan in 1979. Later, this model was adopted by Bank al-Jazeera in Saudi Arabia, but it is believed not be commercially viable even though it fulfils the original objective of Islamic economics; hence, it is not a popular model in the *Takaful* industry.

3.2.2. *Wakalah* (Principal-Agent) Model

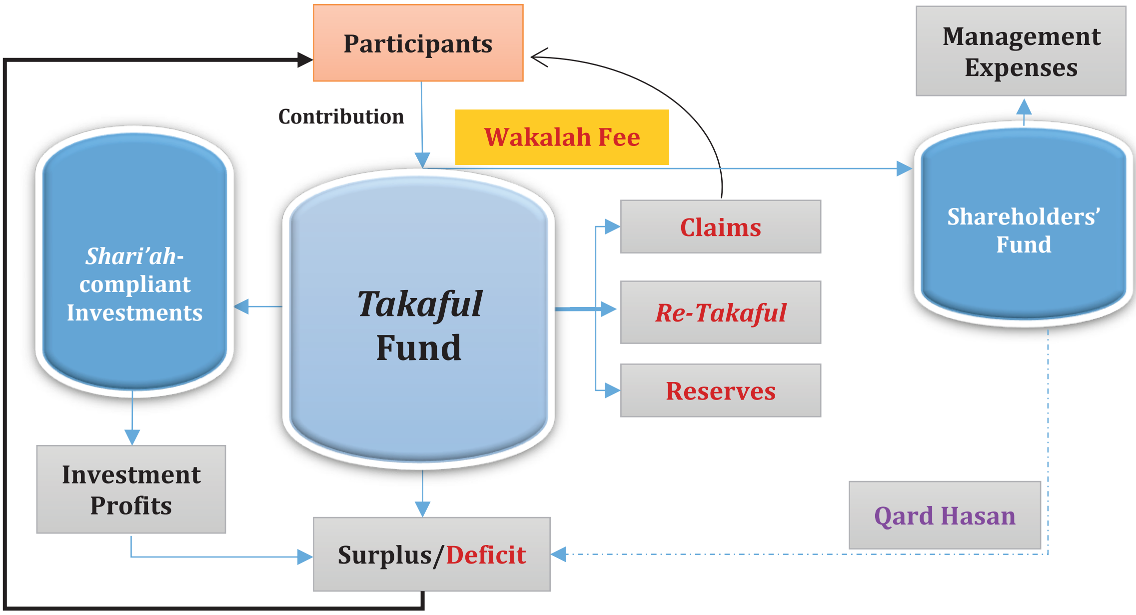
The term *wakalah* in Arabic means 'agency'. The model adopts the agency contract where the principal appoints an agent to perform a specific task, which contractually involves an appropriate consideration in the form of agency fees. Kassim (2005) tried to simplify this model as '*one person representing the other as the latter's agent*'. In the *wakalah* model, the TO serves as an agent of the participants, collectively. This model is widely used in the *Takaful* market and it has been used since 1979 in the Middle East but adopted in Malaysia by *Takaful* Ikhlas in 2003.

There are two unique *wakalah* models in the market: that is, the pure *wakalah* and the modified *wakalah*. The structure for both models is quite similar except for the part that involves the distribution of the underwriting surplus. The structure of the pure *wakalah* model is shown in *Figure 4*:

1. A contribution is paid by the *Takaful* participant as *tabarru'* to the *Takaful* fund;
2. *Takaful* participant appoints and employs the TO as agent or *wakil*;
3. The agent will deduct the *wakalah* fee from the contribution (this fee will be an upfront charge and go to the shareholders and agent, in addition to the fee for administering the fund);
4. The amount of contribution after deducting the *wakalah* fees will go to the *Takaful* fund;
5. *Takaful* fund will be invested by the agent in *Shari'ah*-compliant instruments;
6. The profit from the investment will be added to the *Takaful* fund. Then the claims, reserves and *Re-Takaful* will be subtracted;
7. The whole surplus in this model must be distributed back to the participants.; and
8. In case of underwriting deficit, the TO commits to provide the fund *qard hasan* (interest-free benevolent loan) to cover the shortage. Moreover, when the *Takaful* fund achieves surplus later, the loan the TO earlier provided to the fund will be fully redeemed.

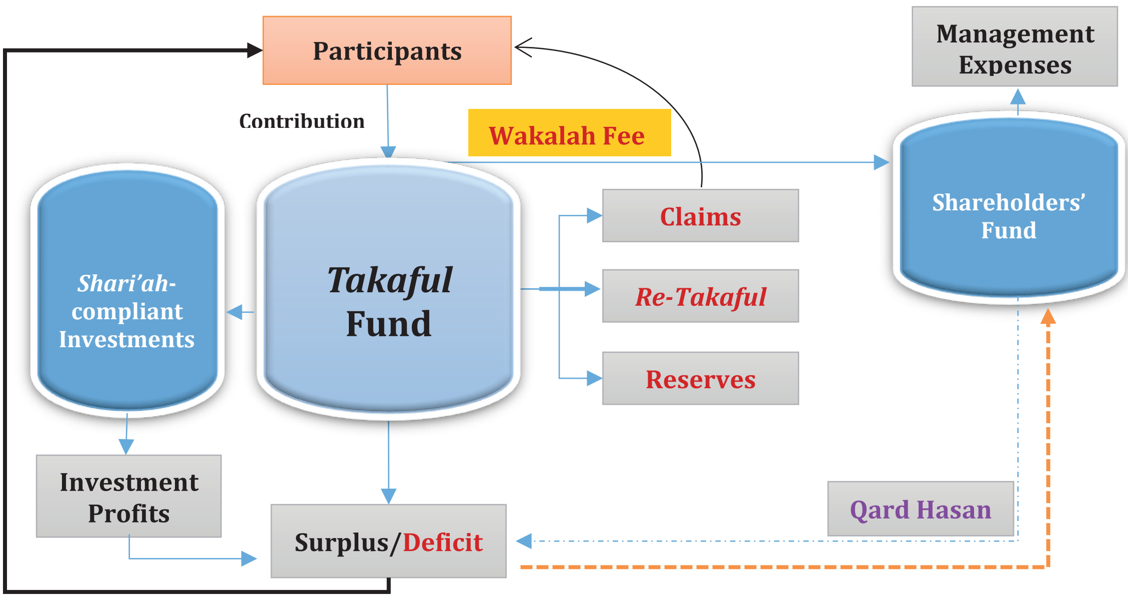
This Pure *Wakalah* model is adopted on a commercial basis, whereby the TO charges a certain *wakalah* fee for managing the *Takaful* fund: claims, investment, underwriting surplus, *Re-Takaful*, and other related expenditure. The *wakalah* fee includes both agency fee and administration charges.

FIGURE 4: PURE WAKALAH MODEL



Notes: The figure presents two parties – Participants and TO. *Takaful* Fund and Shareholders' Fund are both managed by the TO. *Source: Adapted from PwC (2008).*

FIGURE 5: MODIFIED WAKALAH MODEL



Notes: The figure presents two parties – Participants and TO. *Takaful* Fund and Shareholders' Fund are both managed by the TO. *Source: Adapted from PwC (2008).*

In contrast, in the Modified *Wakalah* model, the TO claims a portion of the underwriting surplus as an additional incentive for efficient performance (see Figure 5).

3.2.3. *Mudarabah* (Profit Sharing) Model

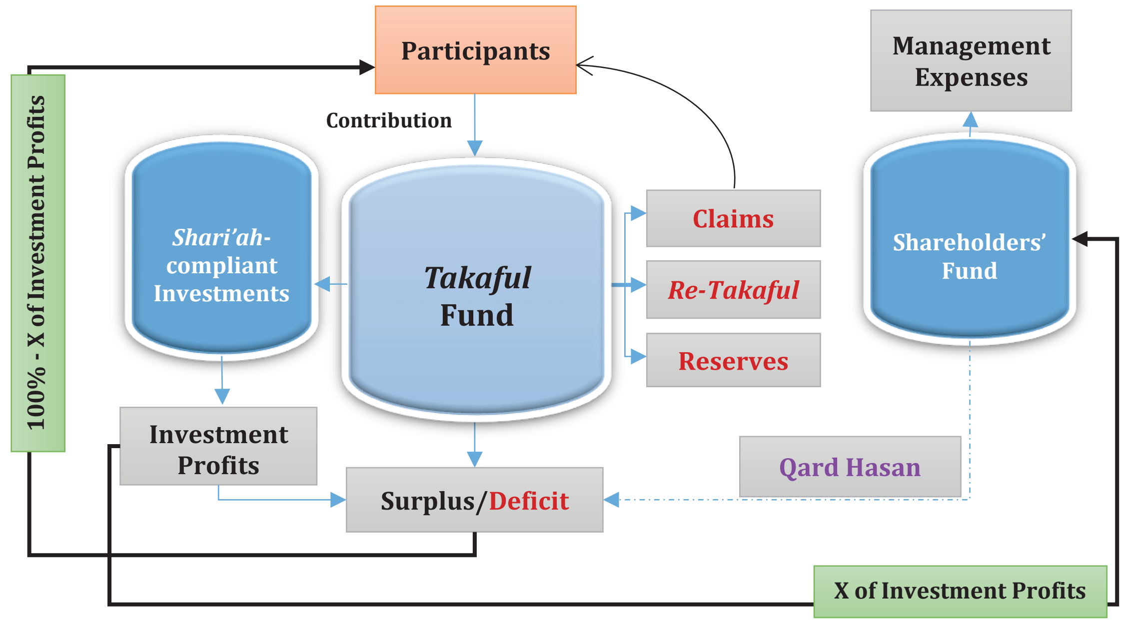
The *mudarabah* model is based on a mode of financing in Islamic finance that is based on a partnership contract between a capital provider, who is usually the sleeping partner and the entrepreneur, who invests the funds in a *Shari'ah* compliant business. In a typical *mudarabah* contract, one party provides the capital, known as *rab al-mal*, or capital provider, while the other party, known as the *mudarib* or entrepreneur offers his or her expertise in business management and investment.

The profit-sharing ratio will be agreed upfront between the parties, while in case of financial loss, it will be borne solely by the capital provider except in cases of explicit negligence on the part of the entrepreneur. In the absence of such explicit negligence, the entrepreneur is deemed to have incurred loss in time and effort when the entire business venture incurs financial loss (Frenz & Soualhi, 2010). To transpose this contractual relationship to *Takaful* operations, participants play the role of *rab al-mal* while the TOs are known as *mudarib*. *Figure 6* below illustrates the pure *mudarabah* model, which is explained as follows:

1. *Mudarabah* contract will be signed between the TO and participants, which will determine the pre-agreed profit-sharing ratio;
2. Then, a contribution will be made by participants to the *Takaful* fund through the *tabarru'* contract;
3. The TO invests the fund in *Shari'ah*-compliant investments;
4. Each party shares the investment profit according to the pre-agreed ratio. The share of the participant will be transferred into the *Takaful* fund; and
5. The *Takaful* fund will deduct the claims, reserves and *Re-Takaful,* and the surplus belongs either 100% to the participants (Pure *Mudarabah* Model) or is shared with the TO (Modified *Mudarabah* Model).

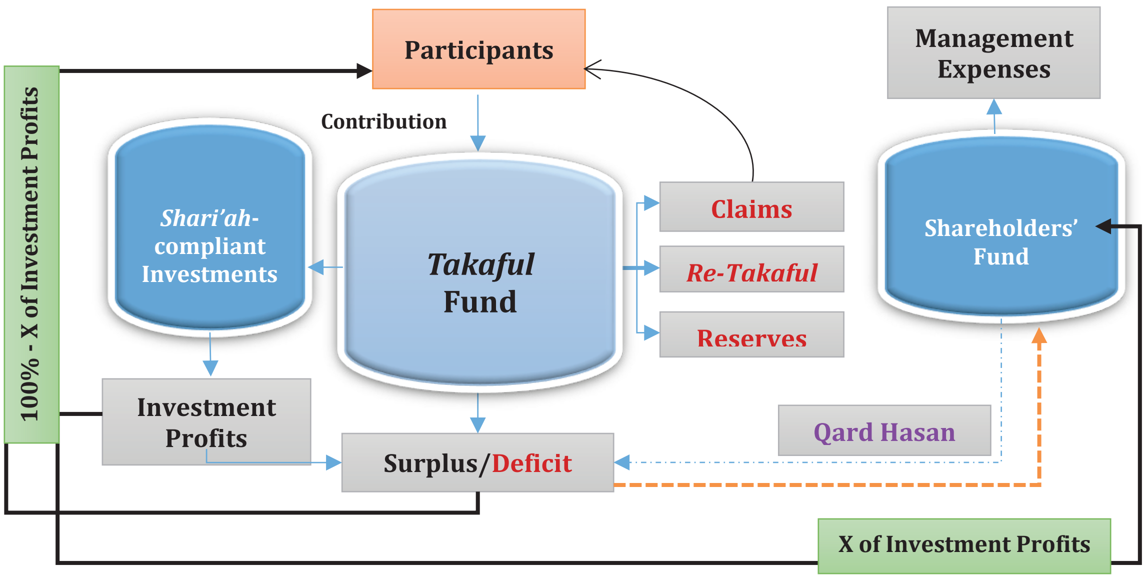
This Pure *Mudarabah* model operates on a commercial basis whereby TO is compensated for his management expertise with pre-determined shares of profit from the investment of funds. In General *Takaful* plan, "idle" financial resources from the risk fund are invested to generate profit. In the Family *Takaful* plan, the *Takaful* fund consists of two pools: Participants' Account (PA) and Participants' Special Account (PSA). The first one is used for savings purpose, while the latter serves as a risk fund for managing claims and underwriting costs.

FIGURE 6: PURE MUDARABAH MODEL



Notes: The figure presents two parties – Participants and TO. *Takaful* Fund and Shareholders' Fund are both managed by the TO. *Source: Adapted from PwC (2008).*

FIGURE 7: MODIFIED MUDARABAH MODEL



Notes: The figure presents two parties – Participants and TO. *Takaful* Fund and Shareholders' Fund are both managed by the TO. *Source: Adapted from PwC (2008).*

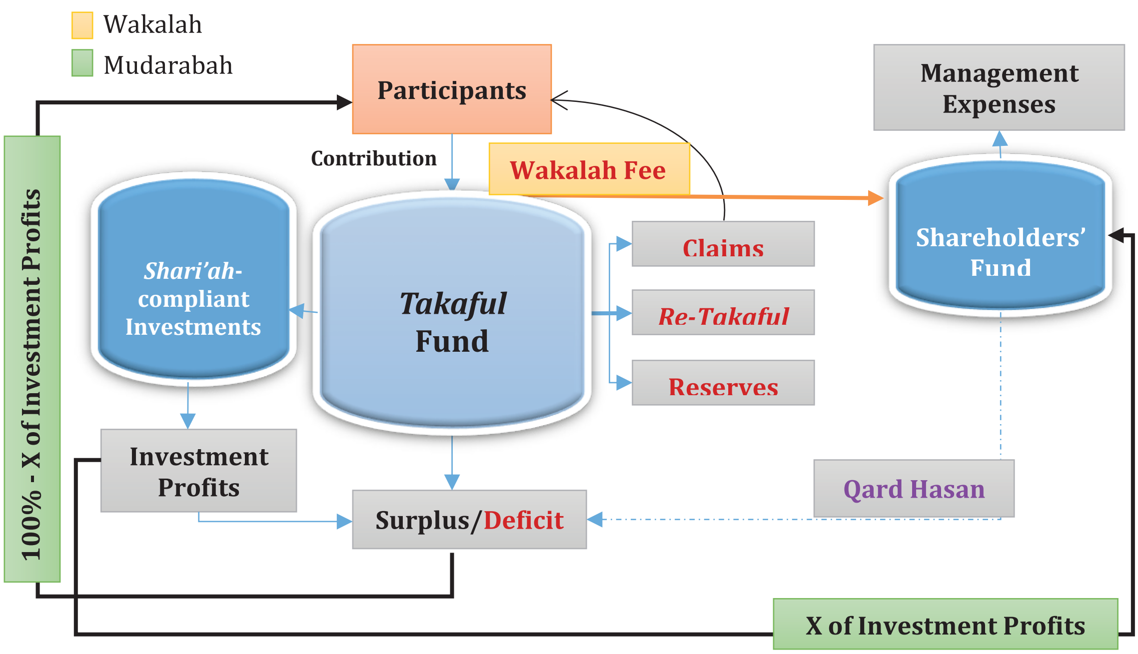
In contrast to pure *mudarabah* model, under the modified version of this model (see Figure 7), the TO shares the underwriting surplus with the participants as an incentive for efficient management of funds.

3.2.4. *Wakalah-Mudarabah* (Agency-Partnership) Hybrid Model

This hybrid model combines the features of two different models: *wakalah* and *mudarabah*. The *wakalah* contract is used for the underwriting in which the *wakalah* fee is an up-front fixed fee charged by the TO while the *mudarabah* contract is adopted for investing the participants' fund in the Islamic finance market and sharing the outcomes of investment.

The core factor in using the *wakalah* contract is to give the TOs the function as an agent or *wakil*. Hence, the TO will be entrusted with the contributed funds. They are also responsible for the underwriting process. This part pays attention to classify the risks according to their insurability and attributing to each the appropriate rates to be paid. The importance of this is to reduce risks and unnecessary loss of fund. Nevertheless, poor underwriting is considered one of the factors that drive the *Takaful* companies into bankruptcy. Tolefat (2006) emphasised that the mixed model is the prevailing model in the Middle Eastern market, and it is broadly accepted by *Takaful* companies around the world.

FIGURE 8: WAKALAH-MUDARABAH HYBRID MODEL



Notes: The figure presents two parties – Participants and TO. Takaful Fund and Shareholders' Fund are both managed by the TO. *Source: Source: Adapted from PwC (2008).*

The structure of the *Wakalah-Mudarabah* Hybrid model is presented in *Figure 8* above:

1. The participants contribute to the *Takaful* fund through *tabarru'* contract;
2. The participants appoint the TO as agent and *mudarib*;
3. The TO will deduct up-front fee which is called the *wakalah* fee to manage the fund;

4. The remaining amount will be invested by the *mudarib* in *Shari'ah*-compliant investments;
5. The profit of the investment will be divided between the *Takaful* fund and TO, or *mudarib,* based on the pre-agreed ratios; and
6. Claims, reserve and *Re-Takaful* will be deducted from the *Takaful* fund, and the surplus goes to the participants or shared with TO.

It is pertinent to note that the business models adopted for Family *Takaful* differ from the General *Takaful* solely in terms of clear-cut division of the *Takaful* fund into the Participants' Investment Fund (PIF) and Participants' Risk Fund (PRF). Nevertheless, the two funds are in line with the intention of participants who join this business line, which is both protection and investment.

CHAPTER 4: THE TAKAFUL GLOBAL LANDSCAPE

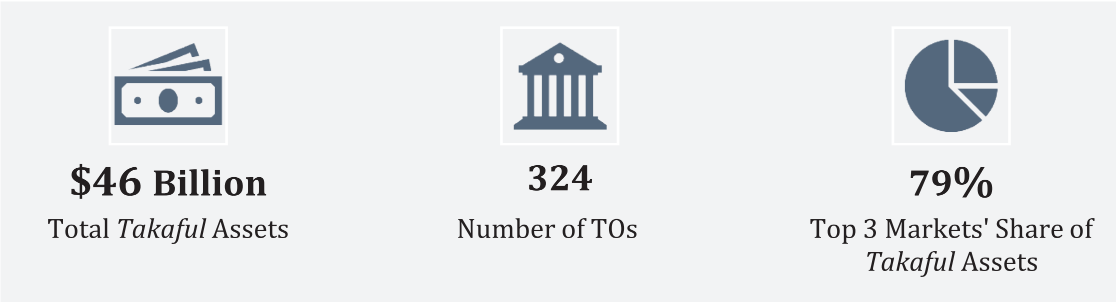
This chapter examines the global landscape of *Takaful*. It analyses the present status of the global *Takaful* landscape by taking into account the average growth rate, assets sizes, profitability and total contributions. It presents figures on *Takaful* and *Re-Takaful* sectors on global and OIC level bases. The chapter concludes with an analysis of some core legal issues relating to *Takaful* legal entity, conflict of laws and interpretation of clauses in relevant contracts.

4.1. Overview of the Global *Takaful* Industry

With the growing dominance of *Shari'ah*-compliant products in Muslim-majority countries, there is a natural preference for products and services that fulfil the needs of Muslims across the world (Khan, 2014). The increasing yearning for *Shari'ah*-compliant products has now gone beyond the original frontiers of Islamic finance (Oseni, 2012). Globally, there are more than 1,389 full-fledged IFIs and windows (Thomson Reuters, 2018). The Islamic finance industry has recorded a compound annual growth rate (CAGR) of 6% from 2012 until 2017. Iran, Saudi Arabia, and Malaysia remained the most significant market contributors to top global Islamic banking markets in 2017. Malaysia is contributing a total of US$ 201 billion in Islamic banking assets compared to Iran and Saudi Arabia. Meanwhile, Iran and Saudi Arabia contribute US$ 486 billion and US$ 376 billion to the global Islamic banking markets, respectively. However, Malaysia has become the second-highest country to have the highest number of Islamic banks around the world with 38 Islamic banks, including Islamic banking windows. Iran has the highest number of Islamic banks with 42 Islamic banks, together with Islamic banking windows. Other than that, Saudi Arabia, UAE, and Qatar also contribute to global markets with 16, 26, and 6 Islamic banks, respectively. The substantial growth was due to increasing demand from those who are religious and more prone to engage with IFIs. Thomson Reuters (2018) projected the Islamic finance industry to grow more than US$ 3.8 trillion in assets by 2023 considering the performance of each market of the Islamic finance industry and the development of its surrounding ecosystem.

Insurance coverage through the *Shari'ah*-based model – *Takaful* – has been one of such innovative products in modern times (Alhabshi & Razak, 2011). Nevertheless, despite the importance of insurance coverage in every aspect of life, the *Takaful* sector is deemed to be lagging when compared to the banking and capital market sectors in the Islamic financial services industry (Mcewan & Connell, 2013). Undoubtedly, the *Takaful* market has gained a high momentum, although *Takaful* contribution is small compared to other markets in the Islamic finance industry. The total *Takaful* assets grew up to US$ 46 billion in 2017 with 324 *Takaful* companies operating around the world in 2017 (see *Figure 9*).

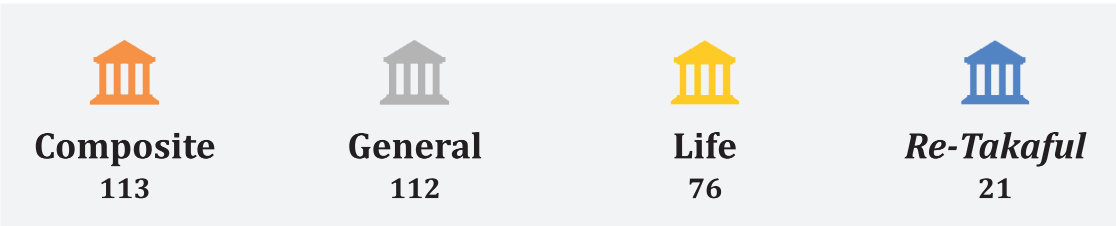
FIGURE 9: TOTAL *TAKAFUL* ASSETS IN 2017



Source: Thomson Reuters (2018)

However, *Takaful* remains the smallest contributor to the Islamic finances industry in terms of assets. Moreover, the top three *Takaful* markets – Saudi Arabia, Iran, and Malaysia - make up 79% of the market's share of total *Takaful* assets in 2017 (see *Figure 11*). Also, there were more than 112 general TOs and 76 life TOs around the world in 2017. For composite *Takaful*, there were 113 composite TOs and 21 RTOs around the world in 2017 based on the total assets in the global *Takaful* market. According to Thomson Reuters (2018), Saudi Arabia is the most significant market that contributed US$ 15 billion in total assets for *Takaful* markets with 35 TOs, including *Takaful* windows in 2017 (see *Figure 10*).

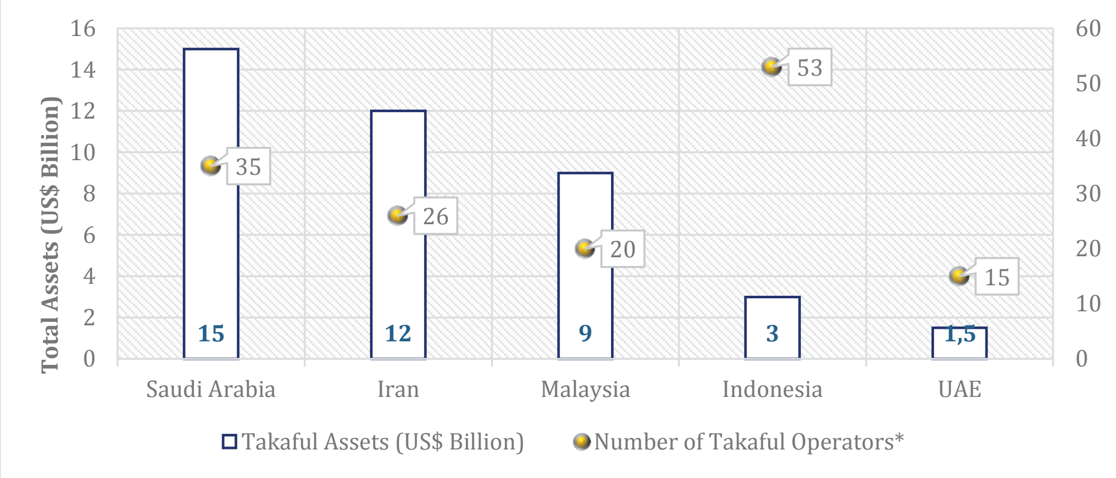
FIGURE 10: TOTAL NUMBER OF *TAKAFUL* OPERATORS - 2017



Source: Thomson Reuters (2018)

Similarly, Malaysia contributed more than US$ 9 billion in total assets with 20 *Takaful* companies operating in Malaysia, including *Takaful* windows. *Takaful* market in Iran is growing slowly by US$ 12 billion in assets with 26 TOs, including *Takaful* windows. The other two countries that contribute to *Takaful* markets are Indonesia and the UAE. Indonesia is the second Asian country after Malaysia, which provides more than US$ 3 billion to global *Takaful* markets.

FIGURE 11: TOP GLOBAL *TAKAFUL* MARKETS 2017



Source: Thomson Reuters (2018)

Based on IFSB (2019), there was 6.9% CAGR between the years 2011-2017 in the global *Takaful* industry. In the Gulf Corporation Council (GCC), there was 6.87% decrease by 2017, whereas there was 8.2% increase in MENA markets in the same period. In 2017, *Takaful* contributions in South East Asia (SEA) is estimated to have reached US$ 3.86 billion up from US$ 2.82 billion in 2016. In Sub-Saharan Africa, even though the market growth is insignificant (US$ 10.2 million), it is believed the region has a tremendous market potential for *Takaful*.

4.2. Trends in Global Regulation of *Takaful*

Modern trends in *Takaful* can be viewed from three main perspectives: regulation and governance, products, and *Shari'ah* compliance. First, from the regulatory and governance perspective, there have been significant developments in different jurisdictions, which led to the emergence of different governance models. The international regulatory landscape remains dominated by the IFSB and AAOIFI through soft regulatory standards (AAOIFI, 2014; Bhatty, 2010; Ullah, Khanam, & Tasnim, 2018).

The IFSB has published five standards and guiding principles regulating the *Takaful* Industry. The standards and guiding principles are identified in *Table 4* below. In addition to these standards, there are other general standards issued by IFSB for IFIs that are applicable to TOs. These include standards on governance framework, the conduct of business, stress testing and liquidity management (IFSB, 2013). Many jurisdictions across the world, particularly members of the IFSB, have adopted the above standards amongst others. The implementation of the three IFSB standards relating to Takaful by Regulatory and Supervisory Authorities (RSA) in 2016 as depicted in Figure 12 below highlights the significant improvement in the adoption of the standards (IFSB, 2017).

TABLE 4: MAIN IFSB STANDARDS SPECIFICALLY RELATING TO *TAKAFUL*

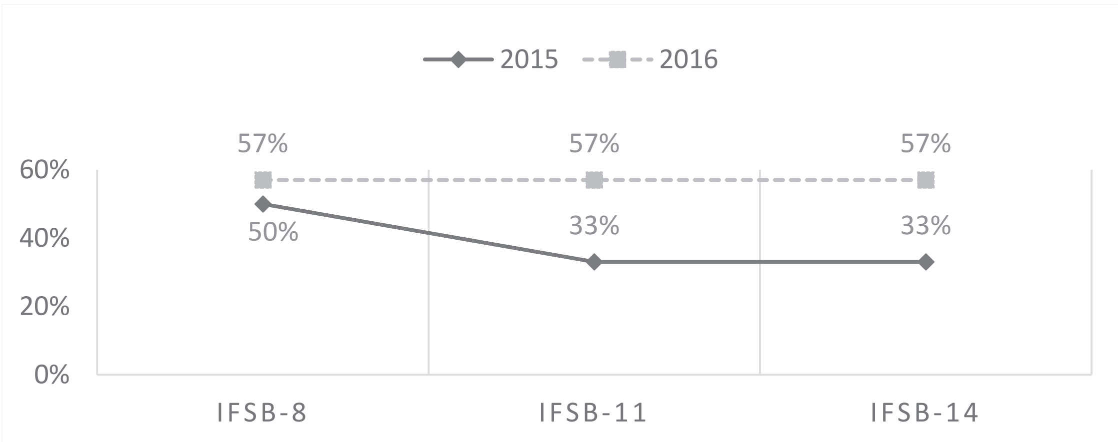
Number	Standard	Date
IFSB-8	Guiding Principles on Governance for *Takaful* (Islamic Insurance) Undertakings	December 2009
IFSB-11	Standard on Solvency Requirements for *Takaful* (Islamic Insurance) Undertakings	December 2010
IFSB-14	Standard on Risk Management for *Takaful* (Islamic Insurance) Undertakings	December 2013
IFSB-18	Guiding Principles for *Re-Takaful* (Islamic Reinsurance)	April 2016
IFSB-20	Key Elements in the Supervisory Review Process of *Takaful/Re-Takaful* Undertakings	December 2018

Source: Authors

The implication of the implementation of the IFSB standards can be viewed from a soft regulatory perspective. This implies that once the IFSB issues its relevant standard, it does not bind the members. Once the members adopt such standards and implement them in their jurisdictions, such standards thereafter become binding on financial institutions operating in such jurisdictions subject to the regulatory treatment accorded to such standards by the RSA.

Similarly, the AAOIFI included its *Takaful* standard in its published *Shari'ah* standards under No. 26 (AAOIFI, 2014). It is important to note that the RSAs in Bahrain, Oman, Pakistan, Sudan, Syria and the United Arab Emirates have all adopted the AAOIFI standards. This makes the *Takaful* standard amongst others binding on all TOs in such jurisdictions. In other countries, such as Brunei Darussalam, Dubai International Financial Centre, France, Jordan, Kuwait, Lebanon, Saudi Arabia, Qatar, Qatar Financial Centre, South Africa, UK, Canada, and United States, the *Shari'ah* standard on *Takaful* is considered voluntary for adoption by operators in such jurisdictions. However, in Malaysia and Indonesia, the RSAs only use the AAOIFI *Shari'ah* standard on *Takaful* as a basis for formulating their national regulatory standards.

FIGURE 12: IMPLEMENTATION OF IFSB *TAKAFUL* STANDARDS BY REGULATORY AND SUPERVISORY AUTHORITIES (2015-2016)



Source: IFSB (2017, p. 53)

Second, in terms of product offering, the *Takaful* sector has witnessed varying practices in different jurisdictions. However, the prevailing products offered in the sector are based on *wakalah* model, *mudarabah* model, hybrid *wakalah-mudarabah* model, and *wakalah* with *waqf* model (Hassan, Kayed, & Oseni, 2013). Regardless of the models utilised, one key issue is the regulatory approach for such models. For instance, different jurisdictions have varying treatments for the surplus in *Takaful* contractual arrangements. For instance, in Malaysia, BNM introduced guidelines for the management and distribution of surplus by TOs in its Guidelines on *Takaful* Operational Framework 2013. The main controversy on the distribution of surplus in *Takaful* undertakings relates to the various *Shari'ah* opinions on the issue, which is both related to the product development on the one hand and *Shari'ah* compliance issues on the other hand. Hence, this issue will be discussed under the third main point (Mokhtar, Abdul Aziz, & Md. Hilal, 2015).

The third trend in *Takaful* relates to *Shari'ah* compliance. There has been a continuous debate on the ownership of the surplus in a *Takaful* contractual arrangement. The three dominant views of *Shari'ah* scholars are as follows:

1. Neither the participants nor the TO owns the surplus,
2. The surplus is exclusively owned by the *Takaful* participants,
3. Both *Takaful* participants and TO jointly own the surplus.

While each viewpoint and its advocates have adduced evidence from the *Shari'ah* to support their respective positions, it suffices to note that the ultimate arbiter on this issue is the regulator or what was earlier referred to as RSA, and after being properly advised by the *Shari'ah* scholars in such jurisdiction.

Before the eventual issuance of the regulatory framework – *Takaful* Rules for TOs in Pakistan in 2012, there was a considerable controversy in the industry championed by conventional insurance operators that TOs might not be able to offer proper *Shari'ah*-compliant products (Akhter & Hussain, 2012). While some have considered this move as a survival tactic, the controversy nevertheless delayed the roll-out of *Takaful* products in Pakistan. In Pakistan, TOs are required by regulatory prescriptions to deal with RTOs for their underwriting needs. However, in the absence of RTOs to undertake such risks, they are permitted to deal with conventional reinsurance companies (Htay, Hamat, Wan Ismail, & Salman, 2014).

In the UK, besides the regulatory framework provided by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), the *Takaful* sector is largely industry-driven as demonstrated in the efforts of the Islamic Insurance Association of London (IIAL), which introduced its Guiding Principles in 2018 to "*provide a platform for the provision of Shari'ah-compliant insurance (Takaful) and reinsurance (Re-Takaful) in the London market*."

The guidelines, which are substantially based on the IFSB standards, were specifically targeted at commercial insurers that plan to introduce *Takaful* windows. It provides a faith-based alternative business model to the conventional insurance business in London (Coolen-Maturi, 2013).

The following *Table 5* presents a historical outline of *Takaful* situated within the context of varying developments across different jurisdictions.

TABLE 5: KEY MILESTONES IN THE DEVELOPMENT OF *TAKAFUL* IN OIC COUNTRIES

Period	Developments
1970s	***1976:*** First International Conference on Islamic Economics, organised by King Abdul Aziz University Jeddah and held in Makkah al-Mukarramah, Saudi Arabia. ***1977:*** First *fatwa* issued by a higher council in favour of Islamic insurance/*Takaful*. ***1977***: The market witnessed a new era after issuing a *fatwa* from the Permanent Committee no.5 1397H stating the permissibility of cooperative insurance operating based on *tabarru'* contracts instead of conventional insurance. ***1979:*** First *Takaful* was launched in Sudan.
1980s	***1980:*** Islamic Arab Insurance Company formed in Saudi Arabia and later in the UAE. ***1981:*** Dar Al Maal Al Islamic Trust formed in Switzerland to set up Islamic banks and *Takaful* companies. ***1983:*** *Takaful* launched in Luxembourg with the establishment of *Takaful* S.A. ***1984:*** The *Takaful* Act enacted in Malaysia and *Takaful* launched with the establishment of *Takaful* Malaysia. ***1985:*** OIC Islamic Fiqh Academy Resolution No. 9 prohibits conventional insurance and allows Islamic cooperative insurance – i.e. *Takaful*. ***1985:*** *Re-Takaful* launched with the establishment of Saudi *Takaful* Limited. ***1989:*** the first Islamic insurance in Bahrain was Bahrain Islamic Insurance Company (BIIC) which was later renamed as the *Takaful* International Company.
1990s	***1991:*** AAOIFI registered in Bahrain. AAOIFI issues accounting, auditing, governance, and *Shari'ah* standards for IFIs. ***1994:*** *Takaful* launched in Indonesia with the establishment of PT Syarikat *Takaful.* ***1995:*** *Takaful* launched in Qatar with the establishment of Qatar Islamic Insurance Company. ***1995:*** *Takaful* launched in Singapore with the establishment of Syarikat *Takaful.* ***1997:*** *Takaful* launched in Dubai with the establishment of Dubai Islamic Insurance Company. ***1999:*** *Takaful* launched in Sri Lanka with the establishment of Amana *Takaful*.

Period	Developments
2000s	***2000:*** The first *Takaful* company - Wethaq *Takaful* - opened the doors for others to enter in Kuwait; ***2002:*** Lebanon–Al Aman *Takaful* established. ***2002:*** IFSB inaugurated in Malaysia. IFSB issues global standards and guiding principles for IFI. ***2003:*** First *Takaful* company incorporated in Pakistan. ***2003:*** The Kuwait National *Takaful* Company started its operations; ***2003:*** Abu Dhabi National *Takaful* Co.P.S.C ('*Takaful* ') was established in the UAE. ***2005:*** SAMA regulations for cooperative insurance supervision enacted. ***2005:*** Bahrain Monetary Authority enacts rules for *Takaful* companies. ***2005:*** Securities and Exchange Commission of Pakistan (SECP) issues *Takaful* Rules in Pakistan. ***2006:*** Three new TOs such as Ritaj, Al-Khalijiyah, and Al-Safat operators started in Kuwait; ***2007:*** Hannover re-enters the *Re-Takaful* market in Germany. ***2008:*** *Takaful* launched in the UK with the establishment of Salaam Insurance. ***2008:*** Methaq *Takaful* Insurance Company is a registered and licensed General *Takaful* Company in the United Arab Emirates. ***2008/9:*** Malaysian Re, Munich Re, Swiss re-enters the *Re-Takaful* industry in Malaysia. ***2009:*** IFSB issues principles on *Takaful* governance (IFSB-8) and *Shari'ah* governance (IFSB-10). ***2009:*** The first *Takaful* company Neova Insurance started its operations in Turkey.
2010s	***2010:*** IFSB issues principles on solvency requirements for *Takaful* (IFSB-11). ***2010:*** *Takaful* regulation introduced in the UAE. ***2010:*** *Takaful* launched in Brunei with the establishment of *Takaful* Brunei Darussalam. ***2011:*** Oman enters the Islamic finance sector following the lifting of decades-long restrictions on *Takaful*. ***2011:*** Takaful launched in Kenya with the establishment of *Takaful* Insurance Africa. ***2011:*** Takaful launched in Palestine with the establishment of Al-Takaful Palestine Insurance. ***2012:*** SECP draft Takaful Rules allow window Takaful operations in Pakistan. ***2012:*** London-based Cobalt, set up in 2012 to promote the growth of *Takaful*, announces the development of a new *Shari'ah*-compliant insurance platform using a syndication model to spread risk more efficiently. ***2013:*** BNM issues a concept paper on the Life Insurance and Family *Takaful* for Everyone (LIFE) framework. The offers cover, among others, operating flexibility,

Period	Developments
	product disclosure, delivery channels and market practices. Once finalised, the initiatives will be reflected in the relevant policy documents to be issued under the Financial Services Act 2013 (FSA) and the Islamic Financial Services Act 2013 (IFSA). ***2013:*** Insurers in Indonesia await a new draft law that proposes a spin-off of their *Shari'ah*-compliant units. Indonesia reshapes its capital requirements. ***2013:*** The *Takaful* sector expands outside its core markets. In the GCC, for example, the growth potential of the industry in Oman is illustrated by the successful IPOs of operators such as Al Madina Takaful and new entrant, *Takaful* Oman. ***2013:*** Nigeria, which aims to become a hub for Islamic finance in Africa, issues guidelines for the centralised oversight of its fast-expanding *Takaful* industry. In April, the vice-chairman of the Chartered Insurance Institute of Nigeria (CIIN) is quoted as saying that *Takaful* has now attained a 70% penetration level in the country's insurance industry. ***2013:*** First Family *Takaful* operator Katilim Pension and Life initiated its operations in Turkey. ***2014/15:*** Some (general) *Re-Takaful* operations in Malaysia are closed or reshuffled. ***2014:*** With the historical introduction of Islamic Financial Services in Oman, Capital Market Authority (CMA) granted licenses to Al Madina *Takaful* Insurance Company and Takaful Oman company. ***2016:*** In Nigeria, the National Insurance Commission licenced two *Takaful* companies – Noor Takaful and Jaiz Takaful. ***2017:*** Two Takaful companies - Bereket Insurance (for General *Takaful*) and Bereket Pension and Life (for Family *Takaful*) – were incorporated in Turkey. ***2019:*** In Turkey, Bereket Participation Insurance and Bereket Participation Pension and Life registered and applied for *Takaful* operating licenses based on new models. ***2019:*** In Nigeria, the National Insurance Commission licenced two *Takaful* companies – Cornerstone *Takaful* Insurance Company Limited and Salam *Takaful* Insurance Company Limited.

Source: Adopted from IFSB-WBG-2017 report

4.3. *Takaful*: An Underexplored Market

Despite the trends at the international landscape of *Takaful* and some efforts made in some advanced jurisdictions such as Malaysia, Saudi Arabia, and Turkey, the potential of the *Takaful* market remains untapped. Despite the large population of Muslims in countries like Indonesia and Nigeria, the rate of *Takaful* penetration remains insignificant trending below 5% in both jurisdictions. Other untapped markets could be found in North America, Europe and Africa. With nearly two billion Muslims in the world with numerous insurable interests, one would have expected the *Takaful* sector to have grown beyond the 2% of the global Islamic financial services industry (Milliman, 2017). It is where major financial centres may play some roles in ensuring that financial inclusion is on the top agenda of all policies. The Chief Executive Officer of Lloyd's, Dame Inga Beale once emphasised: "*It is incredibly important that we in the London Market continually review the products and services we offer our customers around the world and the way we offer them. Having the appetite and capability to provide Shari'ah-compliant risk products will ensure London remains relevant to all communities and will reinforce our position as a centre of innovation.*" (Matcham, 2018). One other key aspect that is trending is the InsurTech sector, where financial technology (FinTech) is applied to scale up insurance offerings. There has not been much development in the application of FinTech to the *Takaful* sector. FinTech provides a great opportunity for micro-*Takaful* penetration in underserved financial communities and new frontiers beyond the Muslim world (Oseni & Ali, 2019).

The penetration of conventional insurance is quite low in rich Muslim regions like the GCC, whereas *Takaful* is rapidly gaining momentum, particularly in the Asia Pacific and the GCC region, owing to a sizeable Muslim population (Alhumoudi, 2013). The OIC Member countries account for about a quarter of the world population. The majority of the world's Muslim population is young, with 60% of this entire population being less than 25 years of age. Catalysed by rising levels of affluence, this large young Muslim population has the potential to represent a customer base for a reasonably long duration if it is captured early.

The *Takaful* industry has gone through three strategic phases of development, as shown in *Table 6* below:

TABLE 6: STRATEGIC PHASES OF *TAKAFUL* DEVELOPMENT

Phase	Development
Phase 1	Slow, then a stormy wave of new companies in *Takaful*, followed by *Re-Takaful* but already retreating (Malaysian *Re-Takaful*, partly Munich Re, General *Re-Takaful* business).
Phase 2	Development of Regulations and *fatawa* for *Takaful* and *Re-Takaful*. Introduction of Risk-Based Capital (RBC) framework for *Takaful* and *Re-Takaful* in Malaysia and RBC in the United Arab Emirates. Further development on the 1985 fatwa for *Takaful* by The Council of the IIFA in 2013.
Phase 3	The slowdown in the establishment of new TOs while existing operators and investors adjust their market strategies towards individual lines in a reaction to excessive volatility in financial results.

Source: Adopted from IFSB-WBG-2017 report

While *Takaful* has continued its steady growth in OIC countries, a focus on the four jurisdictions identified in this study reveals the latest position of things with reference to regulatory and supervisory authorities and market players.

Table 7 below presents the current statistics of the *Takaful* industry in the four countries: Malaysia, Saudi Arabia, Turkey and the UK.

TABLE 7: COMPARISON OF SELECTED COUNTRIES

Country of observation	Saudi Arabia	Malaysia	Turkey	UK
Supervisory/Regulatory body	SAMA	BNM	Ministry of Treasury and Finance	FCA and PRA
Total players	35	15	5	6
Number of local players	35	11	5	6
Number of TOs	35	15	5	6
Number of RTOs	1	4	-	-

Source: Authors' own

4.4. *Takaful* from the Legal Perspective

This section specifically focuses on the main legal issues underpinning *Takaful* ranging from the corporate legal personality of the *Takaful* company, conflict of laws issues, to *Takaful* contracts and interpretation of clauses. From the onset, it is pertinent to observe that except for a few jurisdictions, most of the insurance laws applicable to *Takaful* in various jurisdictions were not originally designed for *Shari'ah*-compliant finance models (Abd Hamid, 2014); hence, there are several legal issues that have cropped up since the modern emergence of *Takaful* in the Islamic financial services industry. While some of the legal issues are peculiar to certain jurisdictions, some selected legal concepts discussed briefly here are corporate personality, legal documentation, and conflict of laws. These legal issues, among others, need to be addressed to improve the *Takaful* sector in any country, particularly in Muslim jurisdictions.

4.4.1. Corporate Personality of *Takaful* Company

The nomenclature of the corporate entity of a TO remains a subject of legal debate. The status of such a company vis-à-vis *Takaful* contributors requires clear identification of roles with particular reference to ownership. For instance, a *Takaful* corporate structure has been referred to as a "firm within a firm", i.e. "a *mutual operating within the set-up of a proprietorship body corporate*." (Hussain, 2009, p. 70). It is therefore important to examine the laws of each particular country to determine whether the set-up of a "mutual" is acceptable or provided for under the domestic laws (Hussain, 2009). This is important when one considers different legal structures in various jurisdictions under the OIC. One may need to produce a legal cartography of the corporate and insurance laws of various OIC jurisdictions to determine which legal structure fits best into the domestic laws. This legal issue goes to the very foundation of the nature and functions of a *Takaful* company vis-à-vis its contractual relationship with the *Takaful* participants and other stakeholders in the corporate structure. For example, in the absence of a "mutual" company set-up, it might be difficult from the legal perspective to set up a *Takaful* company without shareholders.

It is relevant to note that a fundamental question that needs to be clarified under the domestic laws of a country is to determine whether a *Takaful* scheme is a mutual or proprietorship. A mutual structure would envisage a contractual arrangement where the *Takaful* participants, who make the *Takaful* contributions, effectively own the *Takaful* fund. They are responsible for all assets and liabilities. On the other hand, a proprietorship arrangement involves a situation where a corporate entity is issued an operating license and manages the *Takaful* fund with absolute discretion. In this latter model, the shareholders of the corporate entity own the *Takaful* company, including the fund and not the *Takaful* participants (Hussain, 2009). This may have some implications on some of the *Takaful* business models discussed in chapter 3.

In different jurisdictions, *Takaful* companies may take different forms based on local regulations. For example, nowadays in Turkey, the corporate structure of an insurance or *Takaful* company takes the form of a joint-stock company. The Turkish insurance sector is regulated by the following laws: Commercial Code No. 6102 (for insurance contracts), Insurance Law No. 5684 (for corporate, regulatory and operational matters), Turkish Obligations Code No. 6098 (for general contract law provisions), and Private pension activities are regulated by the Private Pension Savings and Investment System Law No. 4632 and its secondary legislation. The implication of a joint-stock company is that a *Takaful* scheme can be operated as a proprietorship under Turkish law, where the shareholding structure exists independently of the *Takaful* participants.

In English-styled common law jurisdictions, like Malaysia, a *Takaful* company is generally regarded as a proprietorship. However, section 21(1) of the Islamic Financial Services Act (IFSA, 2013) provides explicitly that a *Takaful* business shall be a public company. In more specific terms, section 287 of IFSA 2013 goes further to emphasise that a registered TO, which consists of a private company, is to be transformed within twelve months from the appointed date, into a public company, as per the Companies Act, Section 11(1) of the Companies Act 2016, which states that a company limited by shares shall either be a public or private entity. This is consistent with what is obtainable in other common law jurisdictions that recognise a company, whether public or private, to have some shareholding. Therefore, any regulatory framework for *Takaful* must first determine whether it is a mutual or proprietorship or a hybrid of both models under its domestic laws.

4.4.2. Conflict of Laws

Another legal issue in any *Takaful* regulatory framework is the increasing impact of conflict of laws in Islamic financial services and its attendant effect on the *Takaful* sector. It denotes that *Takaful* contractual arrangements are not only required to be *Shari'ah*-compliant but must as a matter of legislative prescriptions, comply with the domestic laws of the jurisdiction. Though it is often said that the English law has its origins in Islamic law (Makdisi, 1998), there exist numerous conflicts between the *Shari'ah* principles and the domestic laws since the former are general principles that are uncodified, while the latter is often not originally enacted to cater to *Shari'ah*-complaints contracts. Consequently, there are always disputes relating to the conflict of both laws, particularly those relating to the interpretation of specific clauses in the contracts (Colón, 2011).

While some cases involving Islamic finance contracts have claimed *Shari'ah* non-compliance of the underlying products in court, others have questioned the very forum of dispute resolution where the jurisdiction of the court itself is challenged.[8] This requires some level of clarity in drafting enabling laws and/or subsidiary legislation on the one hand and legal documentation for *Takaful* on the other to ensure all potentially ambiguous clauses are addressed *ex-ante* (Oseni, 2016).

In cases involving a conflict of laws in Islamic finance contracts, the courts have either resorted to the applicable conventions or invite expert witnesses. There are situations where expert witnesses' opinions are contradictory. This has been experienced in several English cases involving Islamic financial services and products. Hence, in Malaysia, *Shari'ah* issues involving Islamic banking and *Takaful* matters are by-law referred to the *Shari'ah* Advisory Council (SAC), a statutory body whose jurisdiction to determine all *Shari'ah* issues was recently challenged and finally laid to rest in the majority decision in *JRI Resources Sdn Bhd v Kuwait Finance House (M) Bhd (President of Association of Islamic Banking Institutions Malaysia & Anor, interveners)*[9] . In the case, per Mohd Zawawi Salleh FCL held:

> "*The civil courts were not sufficiently equipped to make findings on Islamic law. They were not in a position to appreciate and determine the divergence of opinions among the experts and to decide based on Shari'ah principles. Since its inception, the SAC had been harmonising the proliferation of Shari'ah opinions in the industry. There was a need for certainty in the industry of Islamic banking [and Takaful] principles. Therefore, the binding nature of the SAC's ruling was justified as s 56 of the CBMA [Central Bank of Malaysia Act] was enacted for the purpose of conserving and protecting the public interest*."

This shows the contentious nature of the conflict of laws in the Islamic financial services industry – a phenomenon which remains a significant challenge. This can only be addressed when there is both legislative and judicial clarity. At present, there are different types of legislation relating to *Takaful* in some Muslim-majority countries. While some are enabling legislation, most are subsidiary legislation (Oseni, 2016, p. 136).

4.4.3. *Takaful* Contracts and Interpretation of Clauses

One of the most contentious legal issues in *Takaful* relates to the interpretation of clauses in the *Takaful* contracts. It should be borne in mind that the contracts are modified forms of conventional insurance policies, which one may refer to as "Islamised" forms of such agreements to make them *Shari'ah*-compliant (Mohd Yusof & Oseni, 2019). As a result, they are bound to be disputed relating to the interpretation of specific clauses that are alien to Islamic finance

[8] See the following English cases: *Shamil Bank of Bahrain v Beximco Pharmaceuticals Limited and others* [2003] EWHC 2118 (Comm), *The Investment DAR Company K.S.C.C. v Blom Development Banmk S.A.L* [2009] EWHC 3545 (Ch), and in the following Malaysian cases: *Tahan Steel Corp Sdn Bhd v Bank Islam Malaysia Bhd* [2004] 6 MLJ 1, *Bank Islam Malaysia Bhd v. Rhea Zadani Corp Sdn Bhd and Ors* [2012] 10 MLJ 484. In those cases, the "The courts have consistently considered such a defence as merely "a lawyer's construct" which holds not water in the determination of the case." See (Oseni, 2015, p. 384)
[9] [2019] 3 MLJ 561.

principles. For instance, the nomination clause in modern *Takaful* contracts has its origin in the conventional life insurance policy. There are situations where a nominee in a Family *Takaful* inherits the property of the participant while depriving other legal heirs. This is why some experts have opined that a nomination clause violates the principles of both *mirath* (inheritance) and *wasiyah* (bequest); hence, the implementation of such contractual stipulations in Family *Takaful* should take into consideration the limits set by the Lawgiver (Allah). Whether the *Takaful* benefit in the nomination will be regarded as *hibah* (gift) or part of the estate of the deceased will depend on how the nomination clause is construed (Abdullah & Abdul Aziz, 2010); hence, proper drafting is required to avoid transposing conventional legal principles that may not perfectly fit into the *Shari'ah* principles relating to *Takaful*.

There are other contractual issues relating to guarantees, indemnity subrogation, insurable interest and utmost good faith. Though some of these concepts have some Islamic bearings, they are originally known to the conventional insurance practice. "*Insurable interest itself ensures that a client can obtain insurance only if susceptible to a loss for which insurance is sought. Indemnity implies that a claim can be made only to the extent of the actual financial loss to the insured. Subrogation entitles insurers to claim from a third party on behalf of the insured. Indemnity and subrogation together ensure compliance with the requirements of insurable interest. The utmost good faith clause is required for the disclosure of all material facts; a condition commended in Islam*." (Hussain, 2009, p. 77). The concepts have since been transposed into the *Takaful* scheme.

There have been cases of manipulations of contractual clauses to avoid honouring claims against the *Takaful* companies. This is where it is important for the regulatory and supervisory authority for *Takaful* in any jurisdiction to ensure the *Takaful* participants are adequately protected. Every legislation relating to financial services, particularly *Takaful* in this case, must pursue the principal regulatory objective of fostering fair, responsible and professional business conduct of the TOs while striving to protect the rights and interest of financial consumers as clearly highlighted in *Pertama Makmur Sdn Bhd v Hong Leong MSIG Takaful Bhd (*formerly known as *Hong Leong Tokio Marine Takaful Bhd)*[10].

[10] [2017] 10 MLJ 506.

CHAPTER 5: ISSUES, CHALLENGES AND FUTURE OF THE TAKAFUL INDUSTRY

Takaful is an important emerging sector in the Islamic financial services industry that has exhibited persistent, exciting growth globally. It offers an alternative to conventional insurance, since its introduction. Nevertheless, there are some issues and challenges that have been identified and addressed in the literature relating to *Takaful*. This chapter illustrates the structural, regulatory and technical challenges facing the *Takaful* market specifically on standardisation, taxation, competitiveness and bankruptcy. The key points are discussed here to find regulatory solutions to them while seeking to improve the overall architecture of *Takaful* undertakings in a jurisdiction. Further, we discuss the expectations about the future development of the *Takaful* industry. While these issues are generally discussed here, the next chapter will provide specific case studies in selected jurisdictions where more issues and challenges are identified with a view to finding policy solutions to them.

5.1. Issues

The major issues identified in the modern *Takaful* industry relate to operational, regulatory, and legal and *Shari'ah* matters, as well as market competitiveness. Most of the issues discussed here are meant to raise probing questions that should intrigue all policymakers and spur further developments of the *Takaful* industry. The issues are derived from existing literature with a view to identifying areas where policymakers should focus on in their efforts towards improving the *Takaful* sector.

5.1.1. Nature of *Takaful* Entity

As earlier discussed, it appears there are still some ambiguities regarding the nomenclature of a *Takaful* scheme even though concepts such as *tabarru'* and *ta'awun* have been relied on in the modern evolution of *Takaful*. A fundamental question that is still relevant in the contemporary discourse is the very nature of the *Takaful* entity, which is important in determining the regulatory and prudential framework for offering *Takaful* products in a jurisdiction (Altuntas, Berry-Stölzle, & Erlbeck Anja, 2011). Though virtually all *Takaful* schemes are profit-oriented, one would wonder whether a charity based *Takaful* arrangement can better serve the unbanked population to enhance financial inclusion through micro-*Takaful* initiatives. Can a concept such as a *waqf* be utilised for such an innovative product through a professional management company? There could be a dedicated *waqf* model for *Takaful* specifically meant to serve public good within a particular society or industry to address some economic injustice (Haneef, Pramanik, Mohammed, Bin Amin, & Muhammad, 2015).

5.1.2. The Performance Level and Competitiveness

In comparison to conventional insurance, it is generally observed that the *Takaful* sector has not picked up momentum like its other counterparts in the banking and capital market sectors. In advanced jurisdictions such as Malaysia, despite political will and the efforts of the regulator to deepen the Islamic financial services industry, the conventional insurance still outperforms the *Takaful* sector. Despite a Muslim population of over 60% in Malaysia, there is still a low percentage of this population having *Takaful* plans. Based on the 2018 figures, only 15.2% of the Muslim population had *Takaful* plans. A penetration rate of 15.2% is not encouraging in Malaysia, particularly when one considers the faster pace of Islamic banking in the same country. Islamic banking is said to be expanding faster than conventional banking, where Islamic financing comprised 32% of all funding in the country by the end of January 2019 (Islamic Banking Insight, 2019).

The stagnation in the insurance market is not only limited to the *Takaful* sector. In Indonesia, the total insurance penetration was below 3% in 2018, while *Takaful* penetration is still far below 0.1%. In general, of the 265 million Indonesians, about 1.7% has an insurance policy (The Jakarta Post, 2018).

The question remains: how to break the spell of stagnation and enhance *Takaful* penetration? What value proposition should be introduced to ensure *Takaful* schemes are not only *Shari'ah*-compliant but also conventionally competitive with added value services to penetrate markets beyond the original frontiers of Islamic finance? Perhaps, the mutual model of *Takaful* entity where the participants own the *Takaful* funds may appeal better to prospective participants. Can new *Takaful* models be introduced where participants can have access to the surplus of their accounts and utilise the funds anytime just like their savings accounts subject to certain limits? Without a doubt, innovation remains the main driver in ensuring sustained financial performance in an increasingly competitive global business landscape.

5.1.3. Financial Accounting and Reporting Obligations

There is generally a lack of standardised accounting treatment of *Takaful* schemes, and this has had some implications on reporting obligations of TOs. Kader, Adams, & Hardwick (2010) found variations in accounting and actuarial practices of various TOs. In jurisdictions where accounting practices and reporting obligations have not been standardised, the *Takaful* sector has witnessed different accounting practices among TOs within the same domain. One such example is seen in the accounting treatment of the *mudarabah* model of *Takaful* (Mohd Puad & Abdullah, 2014).

While some of these practices have been attributed to different *Shari'ah* views on certain products, they can be resolved through standardisation of best practices. This is where the role of international standard-setting bodies such as AAOIFI and IFSB come in to streamline best practices. Therefore, the first point of call for any regulatory or supervisory authority seeking to introduce or improve the *Takaful* sector is to adopt and adapt standards and guidelines on *Takaful* by the international standard-setting bodies. For instance, AAOIFI has its Financial Accounting Standard (FAS) on *Takaful,* and this comprises FAS 12, 13, 15, and 19. The FAS on *Takaful* are currently being reviewed comprehensively, and, it is expected that the revised draft of FAS on *Takaful* will take effect on or before the year 2022 (AAOIFI, 2019). In the absence of an industry-tailored *Shari'ah*-compliant FAS, *Takaful* companies will be left without any choice and must apply the new International Financial Reporting Standard 17 (IFRS 17).

It is pertinent to note that IFRS 17 would significantly change the way *Takaful* companies recognise revenue and profits in the *Takaful* scheme. The new IFRS 17 focuses more on one of the controversial *Takaful* models – life insurance of Family *Takaful*. The impact of IFRS 17 will be felt more in Family *Takaful* since it is based on long-term contracts compared to General *Takaful* even though both forms now have increased disclosure requirements. It will be interesting to see the revised AAOIFI FAS on this issue for TOs.

5.1.4. *Shari'ah* and Legal Issues

There are numerous *Shari'ah* and legal issues that are still subject to controversy. Some of the legal issues have been addressed earlier in this study; and not until they are carefully addressed, there will always be legal risks associated with *Takaful* schemes (Hussain, 2009). Also, *Shari'ah* issues include the distribution of surpluses and the ownership of such surpluses, *Shari'ah* models used in structuring the *Takaful* contracts, underwriting practices and the *Shari'ah* position on such practices. One main issue in Family *Takaful* remains nomination and the applicable Islamic law of inheritance. Though this issue has been briefly discussed earlier, it has a far-reaching implication under the *Shari'ah* and could lead to legal risks where heirs of a deceased person may resort to the courts to determine their legal shares when there is just a nominee under a Family *Takaful* plan as against all legal heirs.

Another *Shari'ah* issue that is yet to be settled is whether the *Takaful's* benefit portion of the participant risk fund can be part of the estate of the participant upon death. It will depend on the determination of the ownership of the fund during the lifetime of the participant. Since the fund in question is the participant risk fund, one may argue that upon the demise of the participant, such funds do not belong to him or her; so how can the funds be considered as part of his or her estate?

5.2. Challenges

There are various reasons that have been cited as the challenges faced by the *Takaful* industry. These include the low rate of penetration, shortage of human capital, inadequate technology capabilities, ineffective governance practices, and lack of innovation in the business model for new market niches (Deloitte, 2015). The *Takaful* sector in the Islamic financial services industry is facing many challenges due to legacy issues relating to product innovation and acceptance of the Muslim populace of *Takaful* products during the early stage about four decades ago. Those legal issues have metamorphosed into new challenges, including the inability of the *Takaful* sector to meet up with the fast-paced developments in the conventional insurance industry (Maysami & Williams, 2006). It appears the *Takaful* sector is still largely overshadowed by the conventional insurance in all jurisdictions despite the gains recorded in the Islamic banking and Islamic capital market sectors. Several challenges identified here include inadequate awareness among the faith-biased financial consumers, lack of political will in some jurisdictions, inadequate *Re-Takaful* capacity, limited investment options, inadequate skilled human resources, weak regulatory support, inadequate distribution capacity and minimal efforts in research and development.

5.2.1. Inadequate Awareness

The low level of *Takaful* penetration in most Muslim jurisdictions speaks volume of the level of awareness of the value proposition of *Takaful* by Muslim consumers. It is challenging to compete with well-established conventional insurance companies, but when one comes up with a good value proposition through innovative products that are not only *Shari'ah*-compliant but also conventionally competitive, then it might be possible to disrupt the existing market.

5.2.2. Lack of Political Will

Some of the jurisdictions that have significantly developed their *Takaful* markets, such as Malaysia have relied substantially on political will. Therefore, to improve the *Takaful* sector in any jurisdiction, government policies must be tailored to fulfil such objective. Such support is required not only from the executive arm of the government but also the legislature and the judiciary. The legislature would pass laws that promote *Takaful* while the executive implements such laws for the benefit of the people. The judiciary will mediate in times of dispute to ensure decisions made are well-thought-out and implemented through its public-interest decisions. In terms of political will, the regulatory and supervisory authority in a jurisdiction may direct that all financial services providers in the country should adopt the AAOIFI and IFSB standards and guidelines relating to *Takaful*. This will immediately streamline all practices in the industry.

5.2.3. *Re-Takaful* Capacity

In order to fully underwrite bigger and complex risk, TOs need *Shari'ah*-compliant *Re-Takaful* companies (Arbouna, 2000). There is a limited number of *Re-Takaful* companies in most jurisdictions even though the market has seen an increasing appetite on the part of some global reinsurance giants in *Takaful*. Such insurance giants that have established their *Re-Takaful* subsidiaries include Munchener Ruckversicherungs-Gesellschaft (Munich Re *Re-Takaful*), Swiss Reinsurance Company Ltd. (Swiss Re *Re-Takaful*), AIG *Re-Takaful*, and RGA Global Reinsurance. Though some *Shari'ah* scholars see no objection in utilising conventional reinsurance methods in *Re-Takaful* business as they believe the methods comply with the *Shari'ah* (Gunardi, Deuraseh, Tahir, & Ahmad, 2013), it is always better to scrutinise the nitty-gritty of such methods and contractual arrangements involved before accepting such methods.

5.2.4. Limited Investment Options

Shari'ah-compliant investment options are scarce. Even in the jurisdictions where the *Takaful* sector's regulatory framework is well established, there exist the challenge of limited investment options. Since TOs do not cover risks like their insurance counterparts, they only manage funds and receive management fees in most cases. So, *Takaful* participants contribute to the pool of funds, and in the event of any loss suffered by a member, such loss is indemnified from the pool. It makes it imperative to invest the funds in a *Shari'ah*-compliant business to sustain the funds. A *Takaful* scheme would not be sustainable if there were no such investment options, and this remains a major challenge in some countries, particularly in most non-OIC member states.

5.2.5. Skilled Human Resources

Inadequate skilled human resources for *Takaful* operations have hindered the growth of the industry. Most professionals who now dominate the *Takaful* sector, including TOs, are from the conventional insurance market. They rely on lawyers and finance experts who do the structuring of products and get such products certified by the *Shari'ah* scholars (Oseni, Ahmad, & Hassan, 2016). When it gets to executing such approved products, there are usually challenges. Most products are fraught with *Shari'ah* non-compliance risks during the execution phase due to lack of expertise in *Takaful* and its unique *modus operandi*.

5.2.6. Weak Regulatory Support

Regulatory challenges have not allowed *Takaful* to proliferate, like other sectors of the Islamic financial services industry. In addition to political will, regulators should endeavour to go beyond giving similar treatment granted to conventional insurance to the *Takaful* sector. There should be a unique regulatory treatment for *Takaful* business considering its nature and its potential in deepening financial inclusion. This includes relevant tax considerations and may include lowering the entry bar to allow more market players to enter into the *Takaful* business. Also, the adoption and/or adaptation of international standards on *Takaful* would allow for consistency and clarity in regulatory practices in a particular jurisdiction.

5.2.7. Inadequate Distribution Capacity

Despite the innovative products introduced so far in the *Takaful* sector, there are still inadequate distribution capacity and channels. There is a need to broaden the distribution channel beyond the agency model, including Banca*Takaful* (Coolen-Maturi, 2013). It may involve incentivising the *Takaful* agents and participants to boost the customer base of TOs. Alternative distribution channels may include targeting large companies such as multinationals that have offices across the world or good network channel in a particular jurisdiction.

5.2.8. Minimal Efforts in Research and Development

In terms of product development, the *Takaful* sector seems to be lagging. It is expected that existing *Takaful* companies will dedicate some funds for research and development (R&D) to spur innovations in the industry. Market research needs to be conducted through collaborations with academic institutions to identify participants' requirements and needs to structure products that meet such needs. Such efforts in R&D may be mandated by the regulatory and supervisory authority through a policy directive to ensure all TOs allocate a minimum amount of funds in every financial year. Alternatively, or in addition, the regulatory and supervisory authority may proactively commission such R&D projects to deepen its *Takaful* sector.

5.3. Future of *Takaful*: Policy Steps towards Overcoming the Challenges

Takaful is established upon the notions of *ta'awun* (mutual cooperation), *tabarru*' (donation), mutual security and guarantee (*tadamun*), mutual protection and assurance (*Takaful*). These basic principles underlying *Takaful* have been used to construct various *Takaful* models and structures. Nevertheless, these *Takaful* models have encountered substantial issues and disagreements. It has produced a tremendous number of *Takaful* models ranging from plain *mudarabah* model to the creation of hybrid *wakalah* or *waqf* model; all are done to find the ideal *Takaful* model. Indeed, it becomes a continuous struggle and efforts for the *Shari'ah* scholars, *Takaful* practitioners and regulators to research and innovate for a perfect model for *Takaful*, taking into consideration of the commercial viability and practical aspects of *Takaful* operations such as pricing, underwriting, actuary and the like.

In terms of markets and practices, it is observed that the offerings and diversity of *Takaful* products are lacking, as compared to conventional insurance, and that the *Takaful* business lacks penetration, The TOs need to design and offer neat products and launch good strategies of marketing in order to reach major markets and actively compete at the global level. Similarly, *Takaful* companies need to adopt investment strategies to ensure positive and stable returns on investment. Even though the offerings and diversity of such products are led by firms from Malaysia, they are consistently imitated and implemented in the GCC and Middle East, many still have concerns that the *Takaful* product offerings replicate trends and products in the conventional insurance market. Besides, there is a recurring concern, which consists of the absence of strategic investment in human capital and professional development, as pointed out by practitioners and policymakers.

Regulatory challenge is another aspect of concern highlighted as being a major obstacle for the development of the *Takaful* industry. The regulatory setup is an essential aspect of the development, the implementation of which will consequently lead to a robust and dynamic *Takaful* system globally. Malaysia continues to lead the *Takaful* market in terms of the regulatory framework for *Takaful*. Being a home for 15 licensed TOs, Malaysia continuously enhances the *Takaful* regulations by introducing specific policy documents to regulate the operation of *Takaful* business, *Shari'ah* governance, *Takaful* pricing and reporting. Similarly, the GCC is also committed to enhancing their *Takaful* regulations and move towards global standards in their *Takaful* practices. This has been facilitated by standards and guidelines issued by IFSB and AAOIFI, which represent best practices. In a similar vein, several jurisdictions in emerging markets such as West Africa and East Africa where *Takaful* is gradually gaining momentum have introduced regulatory guidelines to guide the offering of *Takaful* products (WTR, 2017). However, in most countries, the lack of *Takaful* regulation seems to continue into the foreseeable future. Given this, *Takaful* organisations need to realise the need to address the regulatory compliance, consumer protection and good governance practices to facilitate well-balanced strategies for growth and sustainability.

As the *Takaful* industry is moving towards the ever-changing world of technology, multi-media communication and progressive and continuous inventions, it is very important for the *Takaful* players to develop the sector further in order to maintain the growth of the momentum. The published reports and data show that *Takaful* is still far below its expected potential and have not yet reached the optimal volume. TOs are too small compared by the conventional insurance companies. Not only that, the *Takaful* industry must shape up with the technology to become relevant. In order to overcome this challenge, the *Takaful* industry needs to fully embrace the financial technology (FinTech). This new trend is developing at a fast pace in the conventional insurance industry, which led to the development of the insurance technology (InsurTech) sector. In this digital age, *Takaful* players need to proactively reap the technology advancement to become relevant in the market by investing and deploying new technological solutions; otherwise, the *Takaful* industry would become inefficient and obsolete. New Technology helps opening-up new market segments that were previously unexploited, such as serving younger generations, and lowering the cost of providing new products to the market.

Most importantly, the TOs need to ensure that their scheme is more transparent, being different from insurance. *Takaful* must prove that its image of being an imitator is not right and that it is not following or imitating conventional insurance. *Takaful* must offer unique services that are highly valued and appreciated by all. *Takaful* industry needs to be more innovative and should reach out beyond its niche zone. It needs to focus not only on the required products, but must also be ahead of the expectations of its customers and deliver solutions that are genuinely needed and highly appreciated by both individuals and businesses. It must avoid overly complicated products and should focus on affordable, accessible and easy to understand products and serve the public in a manner that fulfils his expectations of efficient service, fair treatment, transparency and good governance.

From the commercial perspective, *Takaful* potential is massive to provide the missing link for businesses and project infrastructure that require extensive protection. Exploiting these prospects would require a higher *Re-Takaful* capacity. Given the lack of robust *Re-Takaful* market, the *Takaful* industry must consider alternative arrangements to come together to join-up their expertise and business needs. The essential ingredients for the *Takaful* industry are already there - the presence of the world's largest global players, and the Islamic finance system that can be used for pushing and building *Re-Takaful* capacity. What is needed is for the *Takaful* players who are willing to lead the way.

Finally, the *Takaful* industry needs to have the right competent and qualified leaders and staff, because strong leadership and high-skilled staff are very much required to move the industry forward to reach greater heights. The industry needs to seriously plan to build skills and competencies through continuous learning and development programmes to alleviate the *Takaful* workforce. It will create an environment that fosters innovation and growth. The challenge for TOs is not only limited to meeting the extrinsic demand but also in developing the right competence and expertise of their staff members in order to provide a competitive alternative to conventional insurance.

CHAPTER 6: COUNTRY CASE STUDIES AND SURVEY ANALYSIS

Having analysed the conceptual issues and challenges in the *Takaful* sector as chiefly documented in the existing literature by experts, this chapter provides case study analysis of the *Takaful* sector in four jurisdictions. For this purpose, four countries, including one non-OIC country – Malaysia, Turkey, Saudi Arabia, and the UK are selected as case studies based on criteria explained earlier in Chapter 1. Selected countries are analysed in detail by focusing on *Takaful* sector in light of the findings of the previous chapters considering the legal and regulatory framework as well as current trends, sizes, challenges and issues. The chapter concludes with a brief analysis of survey results on current trends on *Takaful* obtained from the four jurisdictions which substantiate the case studies and provide a good prelude to the next chapter on policy recommendations.

6.1. Case Study: Malaysia

Malaysia has firmly established supportive infrastructures required for sustainable Islamic finance, particularly in product development, institutional establishment as well as thought leadership. There has always been a significant support from the Malaysian government and putting in place the right infrastructure for the Islamic finance industry to growth and prosper. The country has attained a top spot in Islamic finance infrastructure development following the adoption of its four-pronged strategic approaches: regulatory framework development, legal and *Shari'ah* framework, products and markets development and enhancement of knowledge and expertise.

Islamic finance, as an alternative to the conventional financing, remains beneficial and continues to add value to the finance market and indeed the Malaysian economy in general. The Islamic finance approach in Malaysia has been comprehensive focusing on specific outcomes. Such an approach has significantly contributed to the exponential growth of the finance industry and to the diversification of the Malaysian economy. Today, Malaysia stands out clear as the world most matured Islamic finance operating side by side its conventional counterpart.

6.1.1. Background

The Islamic finance industry in Malaysia comprises three components: Islamic banking, *Takaful* and Islamic Capital Market. The first two components (Islamic banking and *Takaful*) are legislated by the Islamic Financial Services Act (IFSA) introduced on 30 June 2013 for regulating and supervising Islamic financial institutions (IFIs) that include Islamic banks and *Takaful* companies. IFSA provides regulatory framework and principles that promote financial stability and *Shari'ah* compliances. IFSA also facilitates for the central bank of Malaysia (BNM) to monitor the safety and soundness of IFIs; the proper functioning of the Islamic financial market with integrity and orderliness; the safety, efficiency and reliability of Islamic payment systems and instruments; and fair, responsible and professional business conducts. BNM is also responsible for ensuring that the rights and interests of Islamic finance consumers are well protected.

In 1982, the Malaysian Government established a Special Task Force to explore the possibility of setting up the *Takaful* sector. Based on the recommendations of the Task Force, the *Takaful* Act was enacted by the Malaysian Parliament in 1984, and the first TO was established in Malaysia in November 1984, one year after establishing the first pilot Islamic bank - Bank Islam Malaysia Berhad in 1983 (Laldin, 2008). The establishments of the two Islamic financial institutions were well received because of the dire need of the Muslim community at that time for an Islamic alternative to the dominant conventional financial institutions. Islamic finance and *Takaful* took advantage of the public sentiments and their acceptability to boost the development of the two sectors. The Malaysian government relentless support has been instrumental in transforming the *Takaful* industry and ensuring it continuous growth for more than 35 years. Today, it has grown from a single-player with limited products to 15 TOs and four RTOs; fully integrated into the conventional financial system. The complementary roles of BNM and the TOs in developing a dynamic, resilient and efficient *Takaful* industry have been commendable. In fact, BNM adopted the following four stages of gradual approaches to realize a sustainable growth for the *Takaful* industry:

Stage I (1982-1992): Developing infrastructure to put in place the *Takaful* Act 1984, considered as one of the statutes globally that is fully dedicated to *Takaful* operations. The Act regulates the management of *Takaful* funds, facilitating the establishment of *Shari'ah* committees that oversees and ensures the business operations of TOs conform to Islamic principles. The Act enabled the establishment of the first TO - Syarikat *Takaful* Malaysia - in 1984 (BNM, 2004).

Stage II (1993-2000): Establishing the second TO–*Takaful* National Sdn. Bhd. as a competitor to the first extant *Takaful*. This period witnessed greater cooperation and collaboration among TOs in the region. For example, the ASEAN *Takaful* Group and the ASEAN *Re-Takaful* International Ltd. were established during this time in 1995 and1997 respectively. The year 2000 witnessed further cooperation between the *Takaful* Malaysia and *Takaful* National (nowadays known as Etiqa *Takaful*) to develop a joint Code of Ethics.

Stage III (2001-2010): In the beginning of this period in 2001, the Financial Sector Master Plan (FSMP) was introduced. The FSMP was a catalyst for rapid improvements to the legal, *Shari'ah* and regulatory framework of the *Takaful* sector. FSMP represented an ambitious plan for transforming the Islamic banking and *Takaful* industries into an international hub for Islamic finance. This third stage also witnessed a wave of the birth of several *Takaful* operators such as Ikhlas *Takaful* in 2002, and the establishments of other four *Takaful* businesses between 2005 and 2007. Furthermore, the Malaysian *Takaful* Association (MTA) was established during this time in 2002 to promote the growth of the *Takaful* sector. The MTA was mandated to improve industry's self-regulation through standardizing market practices and further promoting the level of cooperation among the industry players. Four years after MTA, the Malaysian International Islamic Financial Centre (MIFC) was established in 2006 to enhance the Islamic finance and *Takaful* networking and linkages to the global marketplace. MIFC was instrumental in liberalizing the *Takaful* Industry in 2009 to pave way for the licensing of four new family *Takaful* in 2010.

Stage IV (2011- 2019): This period saw further enhancement to the *Takaful* industry. In 2012 there was enforcement of *Takaful* Operational Framework and the revised *Shari'ah* Governance Framework. In 2013, the Islamic Financial Services Act (IFSA) 2013 was passed. This was followed in 2015 by the introduction of roadmap to reform the life insurance and Family *Takaful* (LIFE) Framework by BNM. LIFE framework is tailored towards supporting the long-term development of life insurance and Family *Takaful*.

All these developments have transformed Malaysia into becoming the leader of the *Takaful* industry in South East Asia. The country's penetration of the *Takaful* market remains at 4.7% measured by the percentage of total gross premiums and contribution over GDP. The insurance and *Takaful* sectors earn high total premiums and contributions, which increased by 4.9% (from MYR 63.5 to MYR 66.6 billion) in 2017. Total assets for these sectors also increase by 3.2% (from MYR 299.5 billion to MYR 309.1 billion) in the same year (BNM, 2018). However, by the end of 2018, the lower-income groups in the country still received low rate of *Takaful* coverage. Furthermore, the percentage change of Malaysians with single minimum individual or group Family *Takaful* certificate or life insurance policy also remain low at 41% mark (BNM, 2018).

6.1.2. Legal and Regulatory Framework

The regulatory authorities for *Takaful* consist of the public and private authorities. Public authorities are the institutions that have the statutory powers to regulate the industry. In this respect, non-compliance will result in legal sanctions. Meanwhile, the private authorities refer to associations or institutions which issues the code or rules for the best practices of the *Takaful* industry. On the other hand, the Minister of Finance is the authority that has been charged with the responsibility of finance in Malaysia under the Federal Constitution of Malaysia. The Minister of Finance has the power to enact the law relating to financial matters, which include Islamic finance, and in particular, *Takaful*. Concerning the implementation of Islamic finance in Malaysia, the Minister of Finance has granted the powers and functions to the BNM to promote financial stability and compliance with *Shari'ah* (Section 6 of the IFSA 2013). For instance, BNM provides the recommendations for the Ministry of Finance on the businesses and activities of TOs and their authorization under the provisions under IFSA.

The Islamic Financial Services Act 2013 (IFSA) is the main legislation governing the *Takaful* industry in Malaysia. The introduction of the IFSA 2013 has strengthened the legal frameworks for the *Takaful* industry in Malaysia. All the TOs were given a grace period of five years to comply with the new law (IFSA, 2013). IFSA (2013) divided the *Takaful* business into two categories which are the Family *Takaful* business and General *Takaful* business. The *Takaful* business license is granted by the Minister of Finance pursuant to the recommendation by BNM. In addition, another law that is applicable to the *Takaful* industry in Malaysia is the Companies Act

2016, which is relevant for the TOs in Malaysia because all the TOs must be established as public companies under the Companies Act 2016.

The TOs are required to hold separate capital requirements for the General and Family *Takaful* businesses. Before IFSA 2013, the *Takaful* business was required to have a minimum capital requirement of MYR 100 million for both the General and Family *Takaful* business combined under the composite structure. However, from July 2018 onwards, a separate capital requirement for each entity (Family and General *Takaful*) became mandatory, where a composite company would need MYR 200 million capital to support its General and Family *Takaful* businesses.

TOs need to have good corporate governance under IFSA 2013. They need to appoint an actuary to the Board of Directors. This implied a potential increase of responsibility for the Board of Directors. The new requirement under IFSA 2013 forced the TOs to increase the number of independent directors to address the additional responsibility so that the Board has a higher proportion of technical board members such as accountants, actuaries, and so forth. This new requirement for TOs to set up a Financial Holding company also affect subsidiary TOs in Malaysia; which is subjected to minimum capital requirements. The reason behind the new requirement is to put an independent status in terms of financial liability. Further advancement was made in terms of the effectuation of the Basel III reform packages in order to improve Bank's regulatory and supervisory activity. The reform concentrates on enhancing risk management practices in the banking and insurance sectors, especially the risk that arises from the hasty technological development.

The Islamic Financial Services Board (IFSB) and the Malaysian *Takaful* Association (MTA) are the private regulatory authorities that issue guidelines, best practices, and regulations for the *Takaful* industry in Malaysia. The IFSB, as an international standard-setting organization, advocates and improves the robustness and stability of the IFIs. It is situated in Kuala Lumpur, Malaysia and officially commenced its operations on March 10, 2003. The MTA founded in October 1982 is dedicated to promoting the interests of its members and supervise self-regulation within the *Takaful* industry. Accordingly, the Inter-*Takaful* Operator Agreement (ITA) was officially signed on 22nd May 2008 among all TOs in Malaysia. The ITA provides a common standard among all operators to regulate and control matters relating to pre-contract examination for agents, agency registration system and code of ethics in streamlining markets practices among TOs.

Meanwhile BNM is the main regulatory authority with statutory powers provided by the Central Bank of Malaysia Act 2009. BNM started operation on 26th January 1959 according to the Central Bank of Malaysia Act 1958, which was repealed and later replaced by the Central Bank of Malaysia Act 2009. The BNM as the regulator for Islamic finance in Malaysia has a statutory duty to promote financial stability and *Shari'ah* compliance for the *Takaful* industry in the country. BNM also ensures the safety and soundness of TOs in Malaysia and protects the rights and interest of the *Takaful* consumers. BNM also issues the Risk-Based Capital Framework for *Takaful* Operators (RBCT) in order to meet solvency requirements.

BNM introduced the roadmap of reforms related to life insurance and Family *Takaful* (LIFE) Framework in 2015. This reform is to bolster the long-term progress of life insurance and Family *Takaful*. The progress achieved includes:

a) Greater accessibility to life insurance and Family *Takaful* in Malaysia. The customers are provided with all the information related to affordable products. The percentage of policyholder's awareness of the products remains low even though more alternative distribution channels such as the Internet is being used to promote the product to the public. It will be mandatory for conventional insurance companies and TOs to provide the participants with accurate information to ensure informed purchasing decisions.
b) The gradual removal of limits on operational costs.

BNM revised the standards issued in January 2019 relating to Life insurance and Family *Takaful* Framework (LIFE framework). The new standard is meant to review the investment-linked business for insurers and TOs (IFSB, 2018). This advanced revised standard assures the unprejudiced treatment and proper safeguard of policyholders and *Takaful* participants.

The key requirements in the revised investments linked to business standards include:

1) The introduction of the Minimum Allocation Rate (MAR) to act as a safeguard for customer account values by removing the commission limits that will take effect in July 2019 (for Life insurance) and July 2020 (for Family TOs), respectively. Verily, it will result in commissions being expanded over the longer-term, along with incentives to improved sales and services as well as persistency management for long term investment-linked policies or *Takaful* certificate.
2) Secured expectations for insurers and TOs to direct more sturdy sustainability in order to ascertain an investment-linked policy and *Takaful* certificate that is able to manage the coverage until the end of its contractual term.
3) Improved manifestations for the investment-linked product with proper explanation to assist the customers for better understanding of the key risks and benefits of investment-linked policies and *Takaful* certificates, which will help customers make informed and accurate decisions.

The BNM implemented further reforms in the regulation of TOs. Currently, most of the TOs need to convert their composite *Takaful* into separate licenses. The TOs need to register single Family *Takaful* and General TOs separately. Recently, six composite conventional insurance companies and TOs transformed to single life/family and general licenses from their composite licenses, whereas other five composite conventional insurance companies and TOs retained only their life/family licenses. These transformations are mandatory requirements under the IFSA 2013 and Financial Services Act 2013 (BNM, 2018).

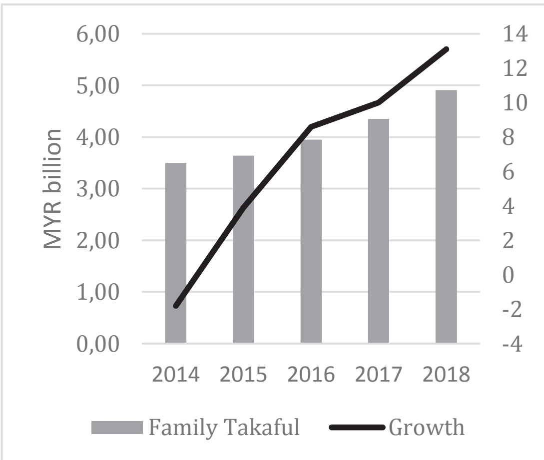
6.1.3. Growth Trends

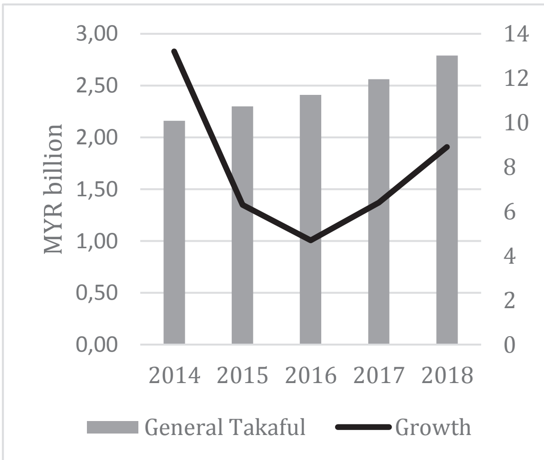
The significant reforms introduced over the years have led to substantial growth in the *Takaful* market. *Figure 13* illustrates the growth of Family and General *Takaful* business in Malaysia. The total Family *Takaful* new business contributions grew by 13.1%, from MYR 4.35 billion in 2017 to MYR 4.91 in 2018. In 2018, the annual contribution for new business showed moderate growth of 4.1%, while single contribution new business jumped to 16.6%. The total Family *Takaful* business contributions grew by more than 11.8% to MYR 4.86 billion in 2018 and increased by 4.6% from MYR 4.74 million in 2017.

According to the Malaysian *Takaful* Association, the *Takaful* industry added 699,534 new certificate holders in 2018, 4.6% more compared to 668,657 new certificates in the year 2017. Meanwhile, the General *Takaful* industry had a decent growth of 8.9% with gross contribution amounting to MYR 2.79 billion compared to MYR 2.56 billion in 2017. Motor *Takaful* contributed to a portfolio mix 62.3%, followed by fire - 20.1% and other classes - 17.2% (MTA, 2018).

Motor *Takaful* recorded a gross contribution of MYR 1.74 billion in 2018, up by 14.6% compared to MYR 1.52 billion in 2017, on top of strong car sales performance.[11]

FIGURE 13: DYNAMICS OF GENERAL AND FAMILY *TAKAFUL* IN MALAYSIA





Source: Adopted from The Edge Financial Daily (March 11, 2019)

[11] The Edge Markets (n.d.) Malaysia's 2019 *Takaful* growth to stay moderate. Available on: https://www.theedgemarkets.com/article/malaysias-2019-takaful-growth-stay-moderate. Accessed on: 22/08/2019

Furthermore, as of May 2019, there are 15 TOs in Malaysia licensed under BNM (see *Table 8*). Malaysia's growth rate in this sector has been increasing since 1984. Over the past 40 years, the number of TOs has climbed from two operators back in 2003 to fifteen operators, reflecting the growing popularity of *Takaful* sector and its increasing importance to the development of Islamic finance.

TABLE 8: LIST OF *TAKAFUL* AND *RE-TAKAFUL* OPERATORS IN MALAYSIA

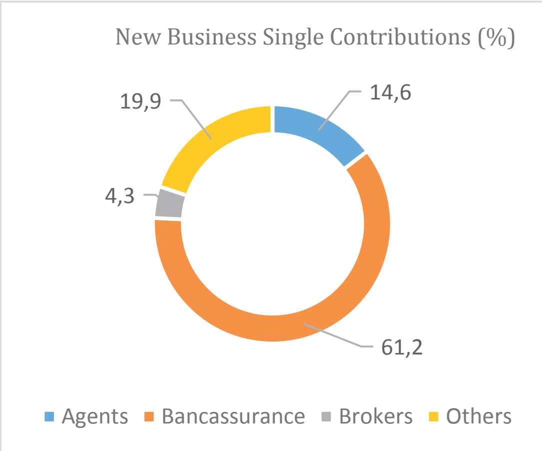
No.	Name of the *Takaful* Operator	Name of the *Re-Takaful* Operator
1	AIA Public *Takaful* Bhd	ACR *Re-Takaful* Berhad
2	AmMetlife *Takaful* Bhd	Malaysian Reinsurance Bhd
3	Etiqa Family *Takaful* Bhd	Munich Re *Re-Takaful*
4	Etiqa General *Takaful* Bhd	Swiss Reinsurance com
5	FWD *Takaful* Berhad	
6	Great Eastern *Takaful* Bhd	
7	Hong Leong MSIG *Takaful* Bhd	
8	Prudential BSN *Takaful* Bhd Local	
9	Sun Life Malaysia *Takaful* Bhd Local	
10	Syarikat *Takaful* Malaysia AM Bhd Local	
11	Syarikat *Takaful* Malaysia Keluarga Bhd Local	
12	*Takaful* Ikhlas Family Bhd Local	
13	*Takaful* Ikhlas General Bhd Local	
14	Zurich General *Takaful* Malaysia Bhd Foreign	
15	Zurich *Takaful* Malaysia Bhd Foreign	

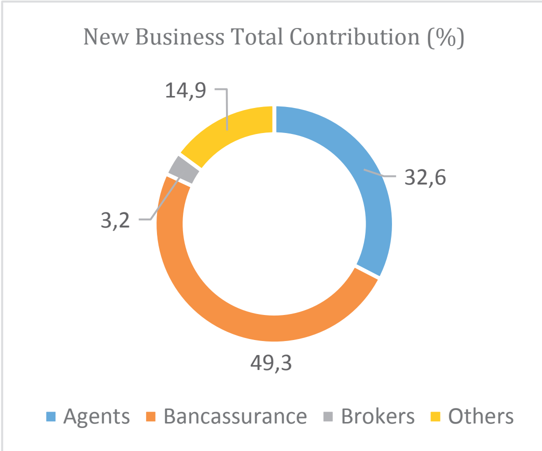
Source: BNM (2019)

According to the Malaysian *Takaful* Association, Family *Takaful* business has shown a double-digit growth (see Table 9). The total new business contributions increased from MYR 4.35 billion in 2017 to MYR 4.91 billion in 2018. For new business single contributions, Family *Takaful* products contributed from MYR 3.12 billion to MYR 3.64 billion. Meanwhile the new business annual contributions in 2017 have increased from MYR 1.22 billion to MYR 1.27 billion in 2018. A total of 699,534 certificates was issued to the policyholders in 2018, an increase from 2.3% to 4.6 % in 2018. The demand for Family *Takaful* has increased rapidly over the years (MTA, 2018).

Table 9: Performance of Family *Takaful* Business of Malaysia

Family *Takaful* Business	Amount	Growth Rate (%)	
		2017	2018
Total New Business Contributions (MYR billion)	4.91	10.0	13.1
New Business Single Contributions (MYR billion)	3.64	9.9	16.6
New Business Annual Contributions (MYR billion)	1.27	10.2	4.1
New Certificate Issues (Units)	699,534	2.3	4.6
Business in Force (MYR billion)	4.86	11.9	11.8





Source: MTA (2018)

Furthermore, General *Takaful* was introduced in Malaysia with particular reference to the fire *Takaful* and motor *Takaful*. From *Table 10*, we find that the total business gross contributions increased from MYR 2.56 billion to MYR 2.79 billion in the year 2018, an increase from 6.4 % to 8.9% during the period. For motor *Takaful*, the gross contributions have increased from MYR 1.52 billion to MYR 1.74 billion showing a significant growth from 4.1% to 14.6%. Lastly, fire *Takaful* contributed only MYR 0.56 billion in 2018 compared to MYR 0.55 billion in 2017.

Table 10: Performance of General *Takaful* Business of Malaysia

General *Takaful* Business	Amount (MYR billion)	Growth Rate	
		2017	2018
Total Business Gross Contributions	2.79	6.4%	8.9%
Motor *Takaful* Gross Contributions	1.74	4.1%	14.6%
Fire *Takaful* Gross Contributions	0.56	9.1%	1.8%

Source: MTA (2018)

6.1.4. *Takaful* Operational Framework

The operational framework developed to guide the TOs contributed significantly to the progress of *Takaful* industry in Malaysia, increased the number of players and expanded the business scope and product range. BNM issued Guidelines on *Takaful* Operational Framework (TOF) in

2012 detailing the parameters for the operational processes of TOs who are expected to meet their obligations towards participants, particularly in adhering to *Shari'ah* principles, undertaking fiduciary duties and meeting prudential standards. Discharging fiduciary duties and responsibilities requires them to recruit appropriate personnel and to have in place appropriate processes and controls, including good governance and oversight structures.

The objectives of TOF (BNM, 2013 June) are to enhance the operational efficiency of *Takaful* business; build healthy and sustainable *Takaful* funds; safeguard the interests of participants; and promote uniformity in *Takaful* business practices. The TOF is formulated to promote the following principles: 1) standardisation of *Shari'ah* principles, 2) prudent management of *Takaful*, 3) fairness and transparency, 4) appropriate charges and good governance and 5) risk management practices.

The TOs are expected to establish an operational model with clear policies, procedures and management responsibilities for *Takaful* operations. The model must uphold the principles of TOF beyond *Shari'ah* compliant contracts. It is mandatory to separate the assets of the *Takaful* funds from the assets of the TOs in terms of family *Takaful* business and general *Takaful* business. TOs must ensure that efficient processes are established to manage *Takaful* funds. These processes should include effective risk controls and strong monitoring systems to protect *Takaful* funds and interests of stakeholders. Effective risk management system must be implemented to identify, assess and analyse the frequency and severity of risks involved. TOs must be constantly responsible for promoting the interest and well-being of *Takaful* funds.

As part of the continuous supervisory framework, and to meet the environmental challenges of competition, changing market and economic conditions, various business practices and different opinions about the operations of *Takaful*, BNM has proposed a new *Takaful* operational framework (see *Table 11* below). The existing requirements for *Takaful* model are based on the agency relationship where TO acts as a manager and administrator of the *Takaful* funds. The new model is proposed to enhance the model by adopting risk-sharing arrangements between TOs and the *Takaful* policyholders.

In addition, the *Shari'ah* contract specifically designed for *Takaful* is also recommended to change from *wakalah* and *mudarabah* to more specific operational requirements for the provision of *tabarru'*, *qard* and *hibah* in the products structuring and legal documentation. The proposal is to outline specific requirements to inform the consumers.

In managing funds, the TOs need to separate between savings and investment funds in the *Shari'ah* contracts. The present requirement does not differentiate between savings and investment funds in the contract. Under the new proposed model, when the TOs manage additional funds, they must determine the policy required to establish and integrate those funds taking into consideration the sustainability of the funds and fair treatment of *Takaful* policyholders.

In conclusion, TOs may decide to offer internal transaction cross trading, which involves an arrangement where the TOs offer simple products to underserved Malaysians particularly the household from the bottom 40% (B40) group. Currently, there are ten insurers and TOs who offer Perlindungan Tenang – affordable, accessible and simple Takaful products. For this unique product, the contributions for the family Takaful product is between MYR 5 and MYR 13 per month for the total sum insured between MYR 15,000 to MYR 33,000. Currently, more than 29,500 policies and certificates have been sold under Perlindungan Tenang products. After the announcement from of Budget 2019, the cost of Perlindungan Tenang products is expected to decrease when a two-year stamp duty exemption is enforced. In addition, the B40 groups also have a long-term security and protection fund to protect and support them from the insurance/Takaful market. The fund can also enable B40 groups who purchase the policy to understand and experience insurance and Takaful.

TABLE 11: PROPOSED ENHANCEMENTS TO THE *TAKAFUL* OPERATIONAL FRAMEWORK OF MALAYSIA

	Existing requirements	Proposed enhancement to the framework
***Takaful* model**	Solely premised on agency contract while the TO plays the role of a manager and administrator of *Takaful* fund	Explicit flexibility to adopt new *Takaful* models such as risk-sharing arrangements
The requirement for *Takaful* Specific *Shari'ah* Contracts	Solely premised on agency contract while the TO plays the role of a manager and administrator of *Takaful* fund	Outlines specifics of operational requirements for the provision of *tabarru'*, *qard*, *hibah* in product structuring and legal documentation
Establishment and management of funds	No differentiation between savings and investment funds	Provides clear demarcation between savings and investment to reflect the relevant *Shari'ah* contracts used for each fund
Management of additional funds	Limited policy expectations and options for consolidation of additional funds	Outlines policy requirement on the establishment and consolidation of additional funds, taking into consideration the sustainability of the funds and fair treatment to *Takaful* participants
Inter-fund cross trading	No specific requirements for inter-fund cross trading	Set out the regulatory expectation for internal controls and TO's conduct on inter-fund cross trading

Source: Financial Stability and Payment Report (2018)

6.1.5. The Most Preferred *Takaful* Structures

In Malaysia, a licensed TO is required to manage *Takaful* operations according to Islamic *Shari'ah*. The TO must ensure a sound and prudent management of the *Takaful* operations. BNM had issued some Guidelines on TOF on 26 June 2013 for the management of *Takaful* and shareholders' funds. The purpose of these Guidelines were to achieve operational efficiency of *Takaful* business and the sustainability of *Takaful* funds.

Furthermore, BNM issued a Policy Document on *Takaful* Operational Framework (TOF) to be enforced on 1st July 2020. This Document summarizes the rules for the management of *Takaful* funds and shareholders fund. The Policy document aims at ensuring the operational efficiency of the *Takaful* business and the sustainability of its funds to safeguard the best interests of the *Takaful* participants. The policy document is developed based on the IFSA 2013, which requires licensed TO to act as the manager and administrator of the *Takaful* funds on behalf of the *Takaful* participants. The policy document summarizes the operational requirements for implementing *wakalah* and *mudarabah* contracts that are currently being used by the industry. Notwithstanding this, the licensed TO may explore new *Shari'ah* contracts for its *Takaful* business model beyond *wakalah* and *mudarabah*. It is, however, subject to prior approval of the *Shari'ah* Advisory Council and BNM.

Types of Operating Models

The most widely used models in the operation of *Takaful* are *mudarabah*, *wakalah* and a hybrid model of *mudarabah* and *wakalah*.

In the *mudarabah* model the participants appoint TO as investment manager based on a pre-determined profit-sharing ratio agreed upon by both contracting parties. The TO shares the returns from the investment of *Takaful* fund (in a Family *Takaful* including the savings components). Investment losses are borne by the participants assuming the losses did not arise due to the negligence of the TO. Otherwise the latter becomes liable for losses in the case of its negligence. On the other hand, the TO in the *wakalah* model provides service related to day-to-day operation of *Takaful*. The TO receives management fee for the operation in addition to getting a share of profit from the investment returns of the *Takaful* fund.

Products of Takaful Business

Section 5 of IFSA 2013 categorizes the products of the *Takaful* business in Malaysia into two: Family *Takaful* and General *Takaful*. Section 2 of IFSA provides the definition of Family *Takaful* business as "*the business relating to the administration, management and operation of a Takaful arrangement under a Family Takaful certificate.*" Furthermore, the Section defines the Family *Takaful* certificate as "*a Takaful certificate by which Takaful benefits are payable on death or survival, including those Takaful benefits payable in respect of personal accidents, disease or sickness, and includes an annuity but excludes a personal accident Takaful certificate*".

Products of Family Takaful Business

The family *Takaful* business products provide opportunities for long-term protection and savings. The participants in this scheme contribute a sum of money to the fund managed by the TO. The contributions are channelled to two separate accounts: Participants' Special Account (PSA) for contributions assigned as *tabarru'* and Participants' Account (PA) for contributions designated as savings and investment. The funds from the PSA are committed for mutual help to participants who have incurred losses from adversities such as death or permanent disabilities. On the other hand, the TO invests the savings in the Participants' Account (PA) and the profit generated is shared between the participant and the TO based on a predetermined ratio. Family *Takaful* protection is classified into two; Individual Family *Takaful* (individuals) and Group Family *Takaful* (employees, clubs, associations and societies).

Included under the individual Family *Takaful* plan are education, investment-linked, annuity, mortgage, health and riders. Participants receive financial benefits from the coverage of adversities such as death or permanent disability. The benefits are also derived from the long-term savings (investment) and investment profits that are distributed upon claim, maturity or early surrender. The Family *Takaful* certificate provides *Takaful* coverage until death or maturity. *Takaful* benefits are paid to the beneficiaries of the deceased upon his death. If the participant survives until the maturity date, the benefits are paid to the participant himself/herself.

For the group Family *Takaful*, the plans include group education, group medical, and retirement. Under these plans, a minimum number of participants must qualify as a group. Financial benefits due to death or permanent disability are the forms of protection the participants receive under these plans.

Products of General Takaful Business

Property or asset is the core the subject matter of General *Takaful*. In order to protect the properties of the participants against financial losses created by adversities, this *Takaful* product provides *Shari'ah*-compliant risk management through risk-sharing. The common types of General *Takaful* products are motor *Takaful*, fire *Takaful*, miscellaneous accident *Takaful*, liability *Takaful*, personal accident *Takaful*, fidelity guarantee *Takaful*, engineering *Takaful* and aviation *Takaful*.

The motor *Takaful* provides coverage to participant's vehicle against loss or damage due to accidents, fire and theft; and/or third-party bodily injury or death and third-party property loss or damage. All motor vehicles are required by the Road Transport Act 1987 to be insured before they can be used on public roads. Third-party risks coverage is compulsory under the Road Transport Act 1987, and it is an offence for any person to use or cause any other person to use a motor vehicle without the necessary coverage.

Fire *Takaful* covers any loss or damage to property caused by fire or other identified threats. There are four types of *Takaful* under this plan, namely basic fire *Takaful*, house owners' *Takaful*, householders' *Takaful* and consequential loss *Takaful*/business interruption *Takaful*. Loss of or damage to buildings such as factories, shops, offices, private dwellings and the like; as well as the buildings' contents such as furniture, fixtures, fittings, office equipment, stocks-in-trade, personal effects and household goods are covered under Fire *Takaful*. Normally such losses or damages may be caused by fire, lightning and explosion of gas used for illuminating and domestic purpose.

Personal Accident *Takaful* is an annual plan that offers compensation in the event of death, disablement or injuries arising only from an accidental cause. Participation in this *Takaful* can be personal or group plan for a family. Personal Accident *Takaful* is also available for short durations, should any accident occur during one's travelling abroad.

6.1.6. Issues and Challenges

The Malaysian insurance and *Takaful* markets face several challenges to achieve its potential despite the robust growth realized over the years. Though the challenges are unique to both the insurance and *Takaful* sectors, the emphasis is placed on the *Takaful* sector. The major challenges identified are as follows:

1. **Lack of Awareness.** In Malaysia, lack of awareness of *Takaful* products hinders the development of the *Takaful* market (Salleh & Laksana, 2018). According to the Malaysian *Takaful* Association, there have been various forms of campaigns and programmes to promote *Takaful* products. These include media plan, community engagement, lecture series and collaboration with other organisations. Lectures are also conducted at several local universities throughout the year to enhance awareness about *Takaful* (MTA, 2018).
2. **Low Penetration Rate.** The *Takaful* penetration rate in Malaysia is still low, especially among the bottom 40 household income segment. Malaysians are categorised by income levels into three groups: Top 20% (T20), Middle 40% (M40) and Bottom 40% (B40). According to the Malaysia Department of Statistics (Yeap, 2019), the mean and the median income for T20 is MYR 13,148 and MYR 16,088, respectively. For the M40, the median and mean household income are registered at MYR 6,275 and MYR 6,502 respectively. Lastly, for the B40 the mean and median income are registered at MYR 3,000 and MYR 2,848 respectively. According to BNM (2018) only 30.3% of the B40 group has life insurance and Family *Takaful* coverages.
3. **Inadequate Technology Capabilities.** The advancement in technology has changed the behaviour of people in the way they save money in banks. However, there seems to be a little change in people's behaviour relative to the *Takaful* market. According to Ernst and Young (2015), the TOs need to invest in appropriate technology platforms to have a good relationship between the customers across products and locations. Malaysia is still struggling to catch up with developments in the insurance technology sector.
4. **Shortage of talents.** The *Takaful* industry in Malaysia is experiencing a severe scarcity of qualified and skilled staffs who are versed in technical insurance principles and have enough knowledge of Islamic law and finance (PwC, 2008). Furthermore, PwC report stated that it is very challenging to find staff with the right talents and skills, especially those with expertise in financial reporting, analytical and business skills.

6.1.7. Lessons learned, Recommendations and Transferring Knowledge

Lessons

Two key lessons and five are derived and five appropriate recommendations are proposed from the Malaysia case study. These lessons and recommendations can serve as important areas of knowledge transfer to OIC and non-OIC jurisdictions seeking to improve their *Takaful* sectors.

1. **Introduction and Development of Regulatory Framework.** In the SEA region, several new regulations have been introduced such as those related to the Family *Takaful* (LIFE) and Life Insurance. This is in addition to the framework introduced to separate the composite companies in Malaysia in 2018. The regulatory development is expected to strengthen the overall industry and enhance its sustainability in the long term (Milliman, 2017).
2. **Sustainability of Pension Schemes and Retirement Planning.** In the SEA region, although there are funded retirement schemes (i.e., predominantly defined contribution schemes), these are currently being provided lump sum at retirement. This gives rise to the lack of financial protection at older age in view of longevity risk. Therefore, there is a need to have retirement planning based on Family *Takaful* products.

There is a need to enhance the existing retirement products being offered in the market, particularly with dissimulation products, to mitigate the longevity risk. Given the lack of market penetration in most countries for Family *Takaful*, the need for retirement planning combined with an ageing society would create an opportunity for the growth of the Family *Takaful* market in most jurisdictions.

Recommendations and Transfer of Knowledge

1. **Supportive Regulatory and Governance Framework:** The regulatory and governance framework is key for the development of the *Takaful* industry in Malaysia. Supportive regulatory framework including corporate and *Shari'ah* governance is crucial for upholding *Shari'ah* values and increasing the impact of *Takaful* to the country's economy and society. BNM, as a supervisory authority of Islamic finance in the country, has been unswervingly supportive of the industry's development. BNM has issued guidelines and policy documents on various aspects of *Takaful* with the aim of promoting product innovation to preserve the sustainability of the industry. This includes the regulation on *Shari'ah* governance and compliance. The duty of *Takaful* institutions is to uphold *Shari'ah* principles and values in their business practices. The IFSA 2013 and Guidelines on *Shari'ah* Governance Framework of Islamic Financial Institutions (SGF) 2010 emphasise the importance of *Shari'ah* governance structure as a mechanism to ensure *Shari'ah* compliance business operations and activities of *Takaful* institutions. Malaysia practices a two-tier governance structure that operates at the central regulatory and institutional levels. The *Shari'ah* Advisory Council of BNM is

the apex *Shari'ah* governance authority in the country that has the authority to ascertain the *Shari'ah* principles for Islamic financial business. On the other hand, the *Shari'ah* committee appointed at the *Takaful* institution is the reference body to advise the Board and management on *Shari'ah* matters pertaining to the specific institution. The *Shari'ah* governance framework assures the integration of *Shari'ah* principles in the overall business, operations and activities of the respective *Takaful* institutions.

2. ***Takaful* and Financial Inclusion:** Malaysia's strategy in developing Islamic finance and *Takaful* include the strategy for financial inclusion. There is a natural affinity of Muslims, being the majority population in the country, to subscribe to *Takaful* products and services instead of conventional insurance due to religious concerns. The *Takaful* industry acknowledges the enormous challenge to reach the community beyond the urban areas, particularly the Muslims among the B40 income category. As a result, the B40 group has been inadvertently excluded from enjoying the benefit that *Takaful* offers. Accordingly, the government has initiated a special insurance and *Takaful* scheme for the B40 population to increase their resilience to financial shocks. The initiative, which is known as *mySalam,* aims to complement the government's ongoing initiatives to increase the insurance and *Takaful* coverage for the underserved group. Pursuant to this, BNM launched *Perlindungan Tenang* initiative in December 2017, with participation of 10 insurance and *Takaful* players to provide simple and affordable insurance and *Takaful* products. The government also encouraged the *Takaful* operators to incorporate technology in their product innovation such as digitalising distribution channels and claims submissions, to become more responsive to the needs of this segment. Digitally-enabled *Takaful* products and services provide greater access, quality and benefit to bigger customer base, particularly the B40. With the help of technology, *Takaful* is playing a greater role in expanding outreach of financial services and increasing financial inclusion.
3. **Embracing Technology**: The Malaysian *Takaful* industry aims to achieve the penetration rate of 75% of the Malaysian population. For this to happen, it is critical that the industry closely interacts with, and fully embrace, technology. *Takaful* customers, particularly the young professionals in Malaysia are digitally active. In fact, 40-50% of the Malaysian workforce is made up of technology-savvy millennials. For sustainability of the *Takaful* industry, the TOs need to seriously master the integration of technology within their operating models beyond just setting up websites or establishing social media presence. *Takaful* players need to explore and embrace FinTech and InsurTech, experiment with chatbots and other types of innovative technology that are capable of independently manoeuvring sales and servicing processes.

4. **Strengthening the Professionalism of *Takaful* Agents:** *Takaful* agents are important component of the *Takaful* ecosystem. Despite their need for *Takaful*, people may not have the time or access to information on *Takaful* products. Agents create that awareness. Many have their first contact with *Takaful* through an agent-initiated

meeting and, to a large extent, tend to rely on agents for information to assist them in making the right decisions, particularly when such involve lifelong commitments. Whilst it is imperative that with the use of technology such as online products and services, the TOs are able to provide seamless customer experience, but this may not necessarily lead to the total substitution of agents. Indeed, the role of an agent is substantially important in developing a comprehensive *Takaful* ecosystem. Both TOs and agents need to work hand in hand to cater to all segments of customers, whether online or offline. Agents can enrich the process by being trained and equipped with useful tools and knowledge to guide and advise potential customers. The *Takaful* industry requires professional agents with well-rounded and holistic capabilities; who are technically qualified, fully committed and uncompromising on ethical standards. This will ultimately guarantee the continued success of *Takaful* industry.

5. **Innovation in *Takaful***: Despite the prospects and potential of *Takaful*, one of the grim realities of the industry is lack of innovation in *Takaful* products and services. Many of the *Takaful* products are a mere replication of the insurance. Considering that *Takaful* is essentially insurance, bound by and based on similar scientific rules and actuarial approaches, the *Takaful* players should explore strategies to advance out of insurance products and operation paradigm. The value propositions of *Takaful* and its products are not being properly highlighted and thus hampering its competitiveness. As it stands now, many consider *Takaful* similar with insurance; and others view it as being unimportant. *Takaful* needs to escape from this "predicament" and immediately improvise innovative strategies to upscale its current offerings. It must eradicate the negative image of *Takaful* as being the imitator, the follower or impersonator of insurance. *Takaful* operators must not compromise their innovative nature and must be able to see beyond *Takaful* as yet another insurance product. *Takaful* must offer distinctive benefits highly valued by all and ensure that its impact is long-lasting and profound to the public. A recourse back to the ethical base *Takaful* is a must for *Takaful* practitioners. They must continuously espouse the positive values embodied in *Takaful* and to translate them into the overall operations of *Takaful* business. Indeed, the very existence of *Takaful* is based on its ultimate objective to attain goodness (*ihsan*) and well-being (*maslahah*) of mankind.

6.2. Case Study: Saudi Arabia

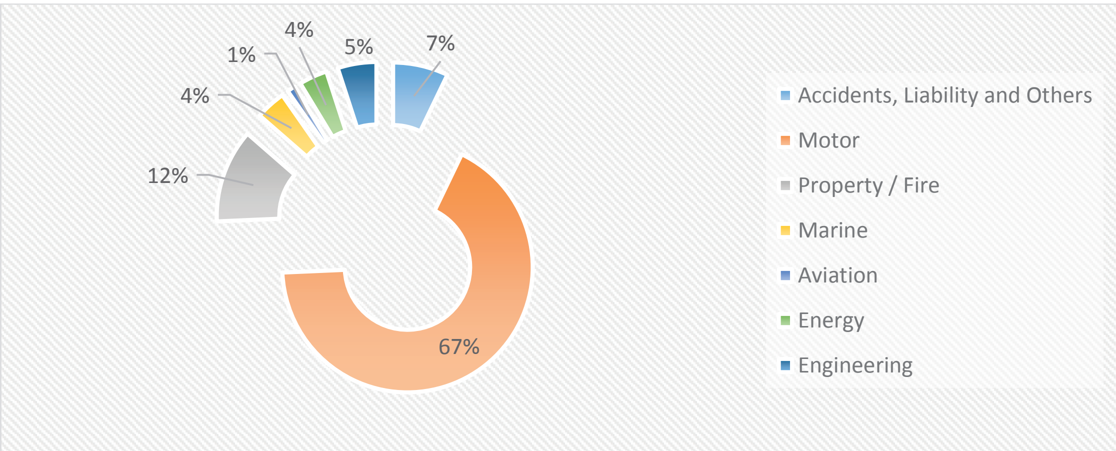
6.2.1. Background

The Islamic financial services industry in Saudi Arabia has rapidly grown over the years to the extent that the Kingdom is now considered among the front-runners of Islamic finance. Saudi Arabia is one of the leading countries in the Islamic finance industry globally and has a deep-rooted history in the industry compared to other Muslim countries. Currently, the position of the country is stable in all the three segments of Islamic finance, namely Islamic banking, capital market and *Takaful*. Saudi Arabia is the largest *Takaful* market (with 38% of global *Takaful* contributions), followed by Iran (34%), Malaysia (7%) and the UAE (6%). However, as a result of the economic slowdown due to low oil prices in 2018, the growth in Saudi Arabia dropped to 2.1% (IFSB, 2018).

In Saudi Arabia, the *Takaful* industry, which is called cooperative insurance, is based on a cooperative model enforced by the Cooperative Insurance Companies law issued in 2005. The cooperative insurance industry consists of 33 cooperative insurance and reinsurance, 38 Brokers, 68 Agents, 3 Consulting firms, 13 Loss Assessors and Loss Adjusters, 10 Third Party Administrators, and 3 Actuarial Services (SAMA, 2019a).

The cooperative insurance in Saudi Arabia consists of General cooperative insurance, health cooperative insurance and life cooperative insurance. General cooperative insurance consists of Motor 67%, followed by Property/ Fire 12%, Accidents, Liability and Others 5%, Engineering 5%, Energy 4%, Marine 4%, and lastly Aviation 1% as of 2018 as presented in *Figure 14* below:

FIGURE 14: GENERAL *TAKAFUL* COMPONENTS IN SAUDI ARABIA (2018)



Source: SAMA Yearly Statistics 2018[12]

[12] www.sama.gov.sa/en-US/EconomicReports/Pages/YearlyStatistics.aspx

6.2.2. The Legal and Regulatory Framework

It is important to note that the Saudi Arabian insurance industry and its legal framework has relatively a long history which is backdated to the twentieth century with the entrance of the international oil companies to explore oil where they have insured their equipment, labours, and their oil tankers. After the establishment of the Saudi Arabian Oil Company (Aramco), the insurance activities spurred in different sectors.

The first regulation of the industry was the Royal decree no. (M/32) issued on 12/6/1931 to regulate the court of trade which allocated a full chapter for marine insurance that was called *Sukurtat*. The latter was followed by resolutions from the Council of Ministers to regulate the industry. However, the first real initiative to regulate the sector was the establishment of the Office of Coordination between the Insurance Companies in 1984 which has established the Saudi Technical Committee for Insurance Companies to prepare a study on the insurance industry in Saudi Arabia and give recommendations. The committee's work resulted in a proposal for regulating the insurance industry in Saudi Arabia.

In 1985, the first public insurance company the National Cooperative Insurance Company) was established (under Royal Decree No. (M/5) dated 17/4/1405H - 9/1/1985. Before that, all the insurance companies in Saudi Arabia were international companies operating through agents and branches. Among the notable initiatives in the development was the issuance of the Royal decree no. (M/10) on the enforcement of the Health insurance on the expatriates and regulating it on 12/8/1999 which was followed by similar resolution for the local people from the Council of Ministers no. (206) on 21/10/2002. By the end of 2003, the Law on Supervision of Cooperative Insurance Companies, circulated by Royal Decree (M/32) dated 31/7/2003, was enacted, followed shortly by the Implementing Regulation of the Cooperative Insurance Companies Control Law, early in 2004. The purpose of the law and its implementing regulation was to regulate the insurance sector in Saudi Arabia (Alhumoudi, 2013).

The key regulatory initiatives in Saudi Arabia include the Insurance Corporate Governance Regulations, the Audit Committee's regulations on insurance and/or reinsurance companies, and the Surplus Distribution Policy. The list of the relevant laws, regulations and circulars is presented in the tables below:

TABLE 12: INSURANCE LAWS DEVELOPMENT IN SAUDI ARABIA

Insurance Laws	Date
Anti-Money Laundering Law	25/10/2017
Cooperative Insurance Companies	17/08/2005

Source: SAMA (2019b)

TABLE 13: INSURANCE RULES AND REGULATIONS IN SAUDI ARABIA

Insurance Rules and Regulations	Date
Implementing Regulations of the Cooperative Insurance Companies Control Law	20-04-2004
Insurance Market Code of conduct Regulations	30-08-2008
Anti-Fraud Regulation for the insurance companies	23-12-2008
Risk Management Regulation	29-12-2008
Regulations for Supervision and Inspection Costs	17-10-2009
The Regulation of Reinsurance Activities	09-11-2010
Insurance Intermediaries Regulation	12-10-2011
Online Insurance Activities Regulation	13-12-2011
Investment Regulations	21-02-2012
Anti-money Laundering & Combating Terrorism Financing Rules	27-02-2012
Outsourcing Regulation for Insurance and Reinsurance Companies and Insurance Service Providers	17-11-2012
Surplus Distribution Policy	19-02-2015
Audit Committee Regulation in Insurance and/or Reinsurance Companies	21-10-2015
Insurance Corporate Governance Regulations	21-10-2015
Actuarial Work Regulation for Insurance and/or Reinsurance Companies	07-01-2016
Regulations for Branches and Points of Sale Annual Expansion for Insurance and/or Reinsurance, Brokerage and Agency Companies	02-05-2016
Rules on the Collection and Exchange of Motor Insurance Information	30-03-2017
Implementing Regulation to the AML Law	25-10-2017
The Unified Compulsory Motor Insurance Policy	01-07-2018
Rules for Licensing and Supervision of Branches of Foreign Insurance and-or Reinsurance Companies in Saudi Arabia	17-12-2018

Source: SAMA (2019b)

TABLE 14: INSURANCE CIRCULARS OF SAUDI ARABIA

Insurance Circulars	Date
Principles to be applied to the regulation of branches of foreign insurance companies established in Saudi Arabia	25/02/2006
Exit Plan to be followed by unlicensed insurers working in the Kingdom of Saudi Arabia	24/12/2007
Explanatory Announcement on the Status of Foreign Insurance Companies Operating in the Kingdom	23/03/2010
Type and Percentage of Ownership in Insurance Companies	24/02/2013
Requirements for Appointments to Senior Positions in Financial Institutions Supervised by the Saudi Arabian Monetary Agency (SAMA)	15/08/2013
Requirements for Appointments to Senior Positions in Financial Institutions Supervised by the Saudi Arabian Monetary Agency	15/08/2013
Medical Expenses- Underwriting Practices 2016	14/11/2016
Engineering Insurance 2016	14/11/2016
Principles for an Effective Risk Appetite Framework	14/11/2016

Source: SAMA

The banking and insurance sectors are regulated mainly by the Saudi Arabian Monetary Authority (SAMA), which also serves as the central bank of the Kingdom of Saudi Arabia. The SAMA was established, under two Royal decrees issued on 25/7/1371H (20/4/1952). The first was No. 30/4/1/1046 provided for setting up the SAMA, its venue in Jeddah, and opening branches across the country as believed to be necessary. The second Decree No. 30/4/1/1047 provided for the approval of the Charter of the SAMA, attached to the decree, and ordering its implementation. SAMA began practising its business in Jeddah on 14/1/1372H (04/10/1952) (SAMA, 2019c).

The SAMA has been entrusted with performing many functions pursuant to several laws and regulations. The salient functions are "*to deal with the banking affairs of the Government; Minting and printing the national currency (the Saudi Riyal), strengthening the Saudi currency and stabilizing its external and internal value, in addition to strengthening the currency's cover; Managing the Kingdom's foreign exchange reserves and the monetary policy for maintaining the stability of prices and exchange rate; Supervising commercial banks, exchange dealers, cooperative insurance companies, the self-employment professions relating to the insurance activity; finance companies and credit information companies*" (SAMA, 2019d).

One of the core departments of SAMA is the General Department of Insurance Control, which is responsible for *Takaful.* Soon after the enactment of the Law and Implementing the Regulation, SAMA established a group of insurance supervisors to operate in its Banking Inspection Department. Since then, the team members are operating as an independent department within SAMA. They are dedicated to the regulation and supervision of insurance activities. SAMA's Insurance Supervision Department aims towards protecting policyholders and shareholders' rights, providing better insurance services that are fair, effective and competitive in prices and covers, fostering the stability of the insurance market, developing insurance market in the region including training and providing employment opportunities for Saudi nationals (SAMA, 2019e).

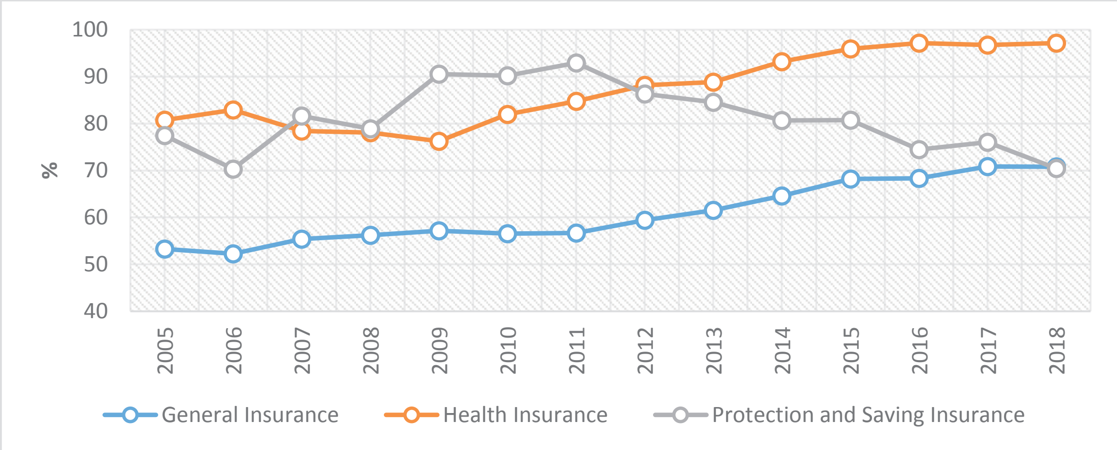
The Saudi Arabia government also took several initiatives towards improving market regulations and encouraging product innovation by issuing Insurance Corporate Governance Regulation on 21st October 2015. This regulation has 6 sections with 132 articles and its main objective is to set high standards of corporate governance within the market while recognising the best international practice.

6.2.3. Growth Trends

Being the leading country in terms of *Takaful* growth, Saudi Arabia had recorded significant growth in *Takaful* product offerings over the years. Health cooperative insurance has witnessed tremendous growth since it was made compulsory by the regulators on all the expatriates in

2005. *Figure 15* below shows that the retention ratio[13] has improved across the years for both General and Health Insurance:

FIGURE 15: RETENTION RATIO

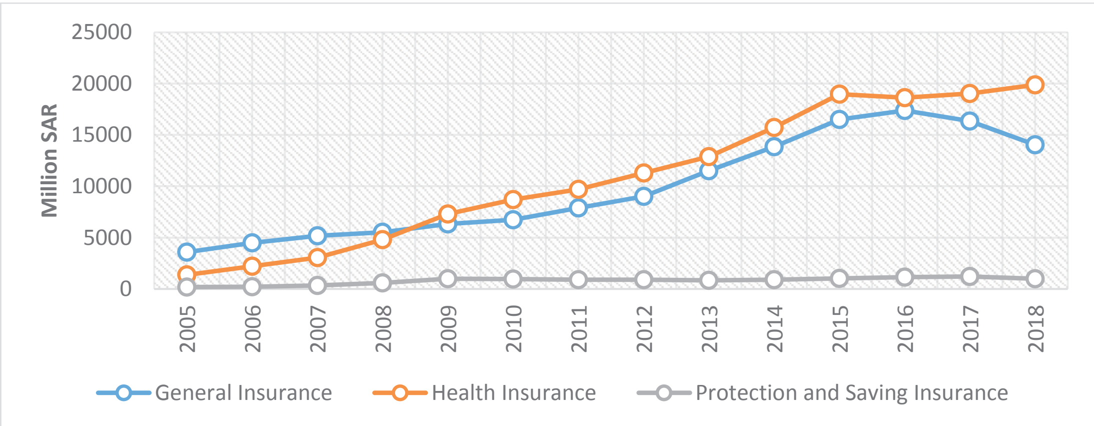


Source: SAMA Yearly Statistics 2018

From the figure above, the retention ratio of the General insurance and Health insurance grew exponentially between 2005-2018 where the General insurance rose by more than 50% and Health insurance by almost 100%, unlike the life insurance which did not witness significant growth throughout the years.

The GWP and Net Written Premiums (NWP) are also other important indicators of the growth of the Cooperative Insurance industry in Saudi Arabia. The GWP of the General insurance grew from SAR 3589.9 million in 2005 to SAR 14028.4 million in 2018. *Figure 16* below presents the growth of the premium from 2005-2018:

FIGURE 16: GROSS WRITTEN PREMIUMS

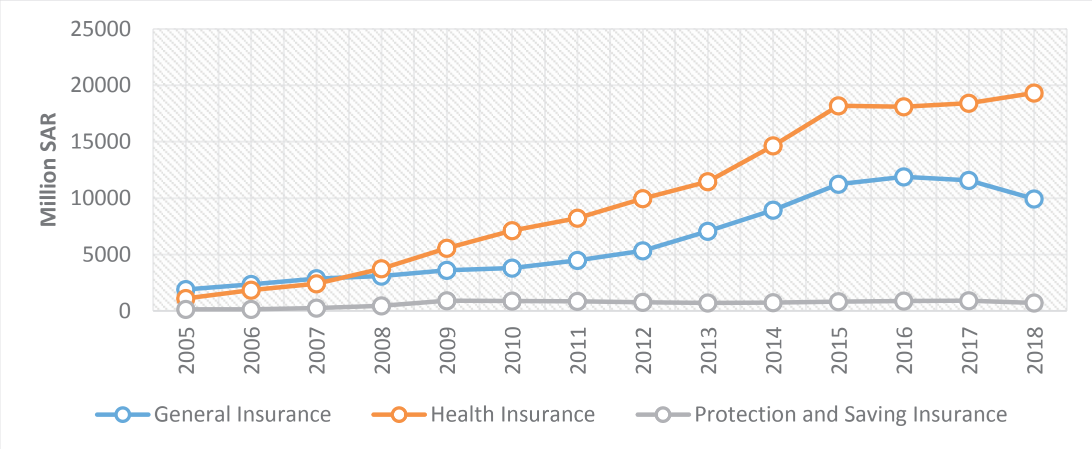


Source: SAMA Yearly Statistics

[13] Retention ratio = Net written premiums / Gross written premiums

Similarly, Health insurance grew from SAR 1,370.3 million in 2005 to SAR 19,883.4 million in 2018. On the other hand, life insurance GWP did not increase much compared to the other two types; it was SAR 193.2 million in 2005 and grew to SAR 1,008.3 million in 2018.

Figure 17: Net Written Premiums



Source: SAMA Yearly Statistics

Figure 17 shows that the NWP of the General insurance grew from SAR 1,912.6 million in 2005 to SAR 9,929.2 million in 2018. Similarly, Health insurance rose from SAR 1,106.6 million in 2005 to SAR 1,9319.4 million in 2018. On the other hand, life insurance NWP did not grow much compared to the other two types where it was SAR 149.7 million in 2005 and grew to SAR 710.1 million in 2018.

6.2.4. The Most Preferred *Takaful* Structures

All the insurance companies in Saudi Arabia are obliged to follow the cooperative model, which requires them to be *Shari'ah*-compliant. The Cooperative Insurance Companies Control Law in Article 1 stated that: *"Insurance in the Kingdom of Saudi Arabia shall be provided by insurance companies registered in the Kingdom operating in accordance with the practice of cooperative insurance in line with the provisions of the Articles of Incorporation of the National Company for Cooperative Insurance issued by Royal Decree No (M/5) dated 17/4/1405H, and not inconsistent with the provisions of Shari'ah*" (WTO, 2003). Nevertheless, the regulators of the cooperative insurance industry did not provide detailed guidelines on the model. Therefore, the practices vary among insurance companies.

The cooperative insurance model practised in Saudi Arabia is not different from the conventional one except that the policyholders get 10% fixed return from the net insurance surplus annually. The Implementing Regulations of the Cooperative Insurance Companies Control Law stated that "*10% of the nett surplus shall be distributed to the policyholders directly, or in the form of a reduction in premiums for the next year. The remaining 90% of the nett surplus shall be transferred to the shareholders' income statement*" (SAMA, 2019f).

The application of the model varies among the companies because of the lack of clear guidelines on the model from the regulator. Therefore, three companies with special permission from SAMA adopted *Takaful* model based on agency instead of the cooperative model with the condition that the agency fees should not exceed 90% of the insurance surplus and the insurance fund deficit will be borne by the insurance company. Two out of the three companies estimated the administrative fees of 5% from the total premiums contributed by the policyholders; additionally, the administrative and operating expenses are borne by the *Takaful* fund. Meanwhile, the third company imposes the administrative and operating expenses on the shareholders and postpones the estimation of the administrative fees (agency fees) to the end of the financial year.

One of the company issued *Shari'ah* parameters on the methods of calculating the fees which consists of deriving them on a fair basis that do not lead to deficit in the *Takaful* fund based on the actuarial calculation, and has put parameters to differentiate between the expenses, costs, and liabilities of the shareholders' account from the *Takaful* fund.

SAMA has adopted the cooperative insurance model instead of the *Takaful* model due to the following:

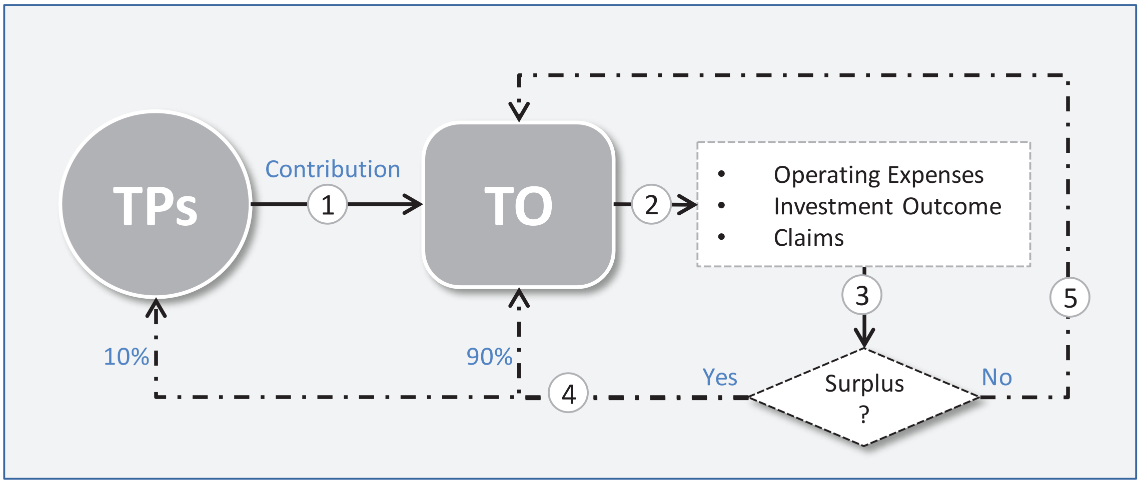
a) The *Takaful* model that is being practiced by some insurance companies does not protect policyholders from the greed of those companies. It is noted that the financial results for insurance companies are often positive (profitable) for the shareholders' fund contrary to the *Takaful* fund whose results are often negative (the fund suffers from an accumulated deficit).

b) The *Takaful* model that was represented in the first insurance experience in the Saudi Arabia was implemented by the National Cooperative Insurance Company; a government insurance company established by a Royal Decree in 1985. This Company was later renamed the Company for Cooperative Insurance). The *Takaful* model adopted by the Company was based on Mudarabah. It was managing the insurance and investment funds of 25% of the proceeds from policyholders' premiums. The *Takaful* was charging the actual administrative and management expenses of the *Takaful* fund. The Takaful Company, however, was not able to meet the profitability benchmark of feasibility study unlike the insurance companies operating in the market in the kingdom.

c) The cooperative model proposed by the Council of Senior Scholars in the Kingdom in resolution No. 51 for the year 1395 AH was not practical because it required the contribution by the insured (policyholder) to be a mere donation. This means that the beneficiaries of the *Takaful* fund could include policyholders and others who do not hold insurance policy or do not contribute to the fund. Furthermore, the surplus from the insurance must be channelled to charity and the policyholders are not entitled to benefit from such surplus because their donation is separate from their liability.

d) The cooperative model has been criticized by scholars from Saudi Arabia due to its inherent *Shari'ah* issues. Fatwas critical of the cooperative model include those issued by the *Shari'ah* advisory board of Al-Ahli Bank no. 89.

FIGURE 18: THE FLOW CHART OF THE 1ST COOPERATIVE INSURANCE MODEL IN SAUDI ARABIA



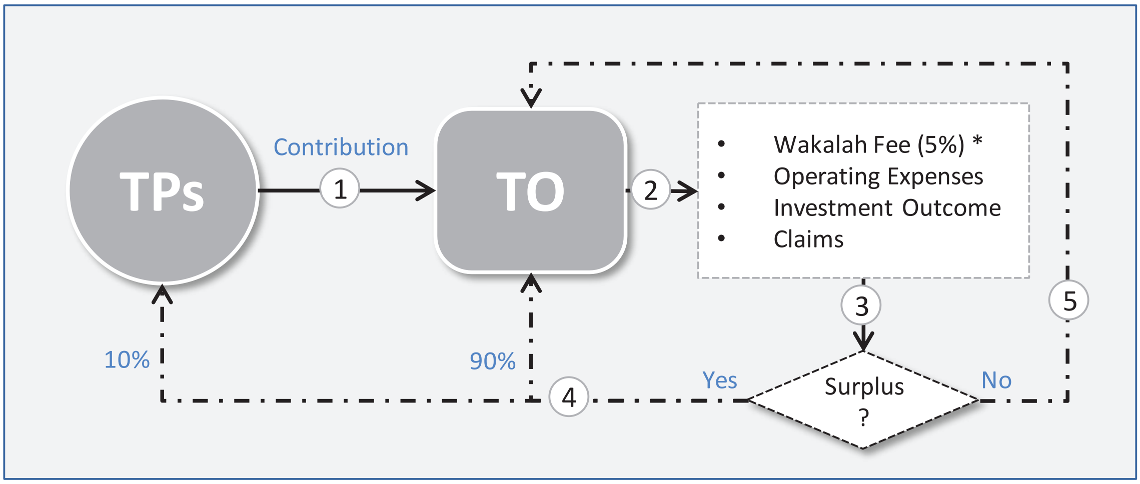
Source: Cooperative Insurance Companies Control Law 2004, Interview with Sulaiman Mohammed Aljewisser

Description/ illustration of the Model:

Figure 18 presents the standard model implemented by the insurance companies in Saudi Arabia, where:

1. Policyholders (TPs) pay the insurance premiums to the insurance operator (TO).
2. A share of the premiums is used to cover the operating expenses, and the other part goes to the investment fund and the risk fund (for claims). The distribution is left to the discretion of the insurance company.
3. At the end of the year, the underwriting surplus/deficit is calculated.
4. If there is any surplus, 90% will go to the shareholders (insurance operator), and 10% is returned to the policyholders based on *Musharakah* in the profit of the insurance company.
5. In the case of deficit, it will be borne by the shareholders of the insurance company based on it is a liability of the insurance company.

FIGURE 19: THE FLOW CHART OF THE 2ND COOPERATIVE INSURANCE MODEL IN SAUDI ARABIA



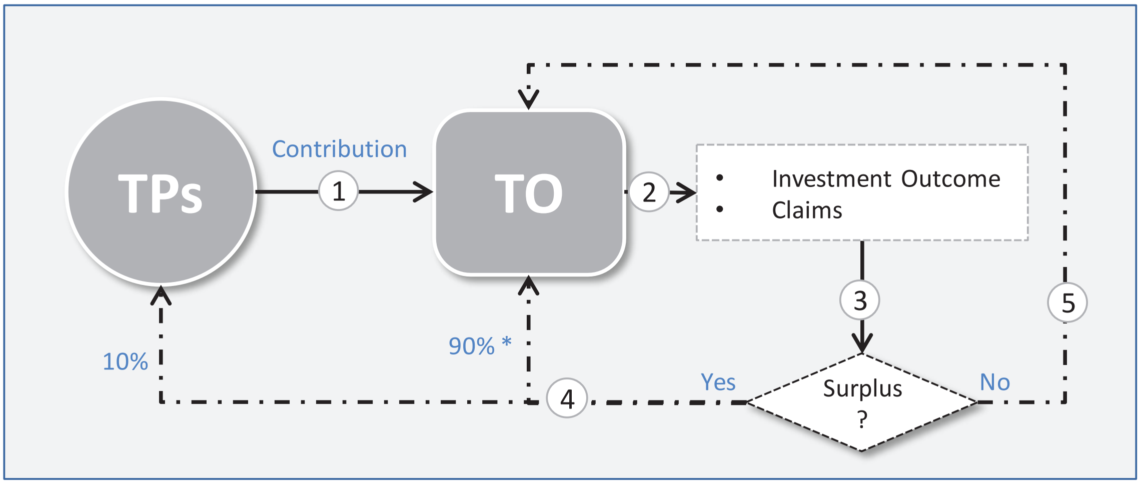
Source: Letter of Approval from SAMA to Solidarity Saudi Takaful Co., and Interview with Sulaiman Mohammed Aljewisser

Description/ illustration of the Model:

Figure 19 presents the second model of the cooperative insurance adopted by Solidarity Saudi *Takaful* Co. and Alinma Tokio Marine Company.

1. Policyholders (TPs) make contributions to the TO.
2. A share of the contributions will cover operating expenses, and the other one is allocated to the risk and the investment funds. A *wakalah* (agency) fee of 5% of the gross premiums is put aside for the insurance operator. The fee should not exceed 90% of the underwriting surplus at the end of the financial year. The percentages of the operating expenses, the claims and investment are up to the decision of the insurance company.
3. At the end of the period, the underwriting outcome – either surplus or deficit - is estimated.
4. If there is any surplus, 10% of it will be distributed among the policyholders as it is permitted by the regulator.
5. In the case of deficit, it will solely be borne by the shareholders of the insurance company based on *qard hasan* (which cannot be claimed back according to the regulations).

Figure 20: The Flow chart of the 3rd Cooperative Insurance Model in Saudi Arabia



Source: Letter of Approval from SAMA to Al Rajhi Takaful, and Interview with Sulaiman Mohammed Aljewisser

Description/ illustration of the Model:

Figure 20 presents the third model of the cooperative insurance implemented by *Takaful* Al Rajhi company where:

1. Policyholders make contributions to the *Takaful* fund operated by the TO.
2. The collected funds will be used by the TO to pay the claims and for investment purposes. The percentages of the operating expenses, the claims and investment are at the discretion of the insurance company.
3. At the end of the financial year surplus or deficit is computed.
4. If there is any surplus, 10% of it will be distributed to the policyholders, and remaining 90% will be used to cover the *wakalah* fee, which is 40% for medical *Takaful* and 30% for Motor and General *Takaful* (from the net premiums). If there is any remaining amount, it will go back to the *Takaful* fund.
5. In the case of deficit, it will be borne by the shareholders of the insurance company based on *qard hassan* (which cannot be claimed according to the regulations).

6.2.5. Issues and Challenges

From the interviews with the experts in the *Takaful* industry in Saudi Arabia, a number of issues and challenges facing the *Takaful* industry were identified; while some of them are local challenges, others are global. The following are the main challenges raised which could be addressed to improve the *Takaful* industry:

- The existing regulations hinder innovations in *Takaful* companies which brings them closer to conventional insurance. This is clear in the enforcement of the cooperative insurance model by the regulator which does not differentiate between the conventional insurance model and *Takaful* and creates difficulties for the *Takaful* companies to comply/harmonise between the *Shari'ah* and legal requirements and prevent them from practising the ideal *Takaful* model.

- The absence of *Shari'ah* governance framework for the Islamic financial services industry in general and *Takaful* sector in specific.
- The need for *Re-Takaful* companies. The existing *Re-Takaful* companies are suffering from the lack of expertise, small capital and inability to cover all *Takaful* risks.
- Lack of awareness among the policyholders and the ability to differentiate between *Takaful* and conventional insurance.
- Most of the scholars' efforts focused on Islamic banking and ignored *Takaful,* which resulted in the underdevelopment of *Takaful* models.
- The regulator focuses more on regulating the similarities between the conventional insurance and *Takaful* rather than the differences such as the distinction between the policyholders and the shareholders' funds.
- Lack of training for members of the *Shari'ah* committees in the *Takaful* companies.
- High competition between conventional insurance and *Takaful*.
- The imposition of 5% tax in the case of *Re-Takaful* outside the country.
- The absence of the training and academic programmes on *Takaful* in academic institutions.

6.2.6. Lessons learned, Recommendations and Transferring Knowledge

Lessons

Several lessons could be derived from this case study. Two major ones are single out here, which may benefit other jurisdictions.

1. **Need for *Shari'ah* regulatory framework for the *Takaful* industry:** The most encouraging part about the *Takaful* industry in Saudi Arabia is that it is required to be *Shari'ah*-compliant by the regulations which is an advantage despite the *Shari'ah* concerns about the cooperative insurance model which could be overcome by issuing detailed guidelines on the model.
2. **Need for *Re-Takaful* Companies to cater to the need of the *Takaful* industry:** There is only one reinsurance company in the country. Therefore, there is a need for *Re-Takaful* companies in the country due to the *Shari'ah* issues raised about the reinsurance company and the 5% tax if any *Takaful* company opt for *Re-Takaful* outside the country.

Recommendations and Transferring Knowledge

There have been notable efforts by the regulators of the insurance industry in Saudi Arabia starting from 2004 by issuing the Cooperative Insurance Companies Control Law and up to date.

However, there is a need to address the challenges faced by the industry. In this regard, we recommend the following:

1. Enhance the existing regulations to address the *Shari'ah* concerns relating to the cooperative insurance model and make a clear distinction between the policyholders and the shareholders' funds.
2. The need for *Shari'ah* governance framework for the Islamic financial services industry as a whole and *Takaful* industry specifically.
3. The need for strong *Re-Takaful* companies.
4. Increase awareness among the policyholders to differentiate between the *Takaful* and conventional insurance.
5. Enhance the proficiency of the *Shari'ah* committees in the *Takaful* companies through training programmes.
6. The need for the training and academic programmes on *Takaful* in academic institutions.

6.3. Case Study: Turkey

6.3.1. Background

According to the World Bank Report (2019), Turkey is the 19th largest economy in the world and the 7th leading country within Europe. Its GDP is valued at US$767 billion in 2018. It started recording high positive rates of growth since the last quarter of 2009. More importantly, Turkey was able to manage and mitigate the adverse effects of the global financial crisis in 2008 and 2009 with its strong economic fundamentals (Saiti, 2017). In other words, the Turkish economy was relatively less affected during the 2008 global financial crisis, compared to the global level of influence that affected most financial institutions worldwide. However, the geopolitical risks, the internal political situation, the coup attempt in 2016, and the currency crash in 2018, have, all, caused some degree of uncertainty in the Turkish economy. Besides, global negativities, like the so-called "trade war" have caused a decrease in tourism and in trade volumes and incomes. Despite the negative internal and external elements, the Turkish economy has sustained an average growth rate of 4.9% per annum for the period of 2014-2018. The country is targeting an average growth rate of 4.3% per annum for the next 5-years (2018-2023). This is outlined in the 11th Development Plan (SBB, 2019). The development of Islamic finance, with a special emphasis on *Takaful* and on Istanbul as a prospective international financial hub, forms an integral part of the Turkish economic strategy for its continued economic growth.

Even though the Islamic financial services industry started late in the country, the World Islamic Banking Competitiveness Report (2016) reported that Turkey is very important to the global growth of the Islamic financial services industry, due to the strong support it receives from the Turkish government (Saiti, 2017). The early development of Islamic finance in Turkey began in 1983, when the government issued a decree (16/12/1983, 83/7506) called "Establishment of Special Finance Houses". However, the industry did not attract enough attention by the market until the new Banking Act No 5411 in 2005, which converted the special finance houses into participation banks (TKBB, 2016). Besides, the Islamic financial system was able to develop an ecosystem, which led to the establishment of the first General *Takaful* company, Neova Insurance, that was introduced to the Turkish economy in 2009 as an initiative of Kuveyt Turk Participation Bank. Four years later, the first Family *Takaful* company, Katilim Pension and Life, was launched in Turkey by Albaraka Turk and Kuveyt Turk participation banks as a joint initiative.

The Islamic financial ecosystem was developed further with the establishment of three new state-owned participation banks, beginning from the year 2015. As of December 2018, there were 52 banks in Turkey. These include 34 conventional banks, 13 development and investment banks and five (5) participation banks (BRSA, n.d.). The five (5) participation banks are: Ziraat Participation Bank, Vakif Participation Bank, Turkiye Finance Participation Bank, Albaraka Turk Participation Bank and Kuveyt Turk Participation Bank. They have between them a 5.35% market share in the volume of the Turkish financial assets by December 2018 (BRSA, n.d).

Recently, a sixth participation bank, Emlak Participation, has been licensed in 2019, to operate in Turkey. With its contribution, not only the market share of the participation banks will go beyond the 5% mark, but their total assets and total financing will be also much larger and will have greater impact on the economic growth and development of the country. Furthermore, the *Takaful* industry is expected to expand further, since the motor distribution channel for *Takaful* in Turkey is the Banca*Takaful*.

6.3.2. Legal and Regulatory Framework

The Turkish financial markets are regulated mainly by four institutions; the Central Bank of Republic of Turkey (CBRT), the Banking Regulation and Supervision Agency (BRSA), the Capital Market Board (CMB), and the Ministry of Treasury and Finance[14]. Among these, CBRT has an important but limited role in the market, which is to regulate the types and maturities of deposit for both conventional and Islamic banks as well as liquidity regulations and legislations on preserving the value of the Turkish Lira (TRY). On the deposit side, Savings Deposit Insurance Fund of Turkey (SDIF) has a supplementary role in regulating the deposit insurance premiums. On the other hand, BRSA used to be a department of Ministry of Treasury and Finance until 1999; however, afterwards, it became separated under the banking act number 4389. Since then, it has been regulating, supervising, and licensing the whole banking sector—e.g., conventional, participation, development and investment banks under the Banking Act (No. 5411), as well as financial leasing, factoring under the Financial Leasing, Factoring and Funding Companies Law (No. 6361), payment services, electronic money institutions and other financing companies under the Law on Payment and Securities Settlement Systems, the Payment Services and Electronic Money Institutions Law (No. 6493) and associated regulations.

Turkey does not have a separate law for Islamic banking sector. The Banking Law No. 5411 regulates the distinction between conventional and Islamic banks only in terms of licensing and fund collection. However, with the recent sub-regulations, the regulations required by the participation banking sector have been made to a large extent. With these sub-regulations, the financing methods of participation banks have been defined in a broad and detailed manner. Fund collection were added to the fund collection by proxy; profit distribution calculations and profit balancing reserve were reorganized; the regulation on the *Shari'ah* governance framework was issued; development and investment banks were allowed to operate in Islamic ways; Central Advisory Board for banking was established within PBAT. These regulations were put into practice, as a result of the efforts of the Islamic banking department established in 2015 within the BRSA. The Islamic banking department also carries out legal applications from the licensing to liquidation of participation banks (BRSA, 2018). Recently, however, the Turkish government issued a new decree number 30888 on 14th September 2019, to regulate the activities of the *Shari'ah* Boards in the Turkish IFIs.

[14] Previously, the Ministry of Treasury and Finance was known as Undersecretariate of Treasury.

On the capital market side, CMB is the main institution regulating capital markets and instruments as well as lease certificates (Sukuk) in Turkey with supplementary roles of Borsa Istanbul (BIST) and Takasbank (clearing house). The first regulation on lease certificates and asset leasing companies (special purpose vehicle for Sukuk issuance) were issued by the CMB in 2010. In the following years, CMB issued developmental amendments on the regulation. Another Islamic instrument introduced by CMB is called real estate certificates, which are developed for funding the construction of housing estates. The CMB doesn't have a separate department for Islamic finance nor a Central *Shari'ah* Board for capital markets.

The Ministry of Treasury and Finance is the sole regulatory actor for licensing, regulating, and supervising the overall insurance sector. The Ministry has two separate departments for regulating and supervising the industry. The first is General Directorate of Insurance and the second is Insurance Supervision Board.

The existing regulation on *Takaful* in Turkey was issued in 2017 by the Ministry of Treasury and Finance (Resmi Gazete, n.d.). The Regulation on Working Principles and Procedures of Participation Insurance (No. 30186) mainly regulates the operating models and the governance of *Shari'ah* Advisory Committee. The rest falls under the common legislation (Insurance Law No. 5684) with conventional insurance. The Regulation has two emphases: one is about technical issues, and the second one is on compliance and governance.

There is a requirement for the separation of the risk fund and shareholders' fund in the Regulation. On the other hand, there is general statement regarding the *Shari'ah* compliance requirement for the investment, operations and products. The Regulation is delegating the responsibility of *Shari'ah* compliance to the *Shari'ah* Advisory Committee. The Supervisory authority implements an on-site inspection for this kind of issues. Qualifications of the members of the *Shari'ah* advisory committee are not regulated. This is in the discretion of *Takaful* companies in current practice.

TOs have the obligation to follow both participation and conventional insurance regulation, which has solvency, capital adequacy, risk quantification and valuation rules. All insurance companies including TOs are required to follow IFRS standards.

One of the important features of the Regulation is that it regulates institution-level *Shari'ah* Advisory Committee for Islamic finance in Turkey. The Regulation first defines the institutional level *Shari'ah* Advisory Committee in Article 3 as "*Committee that monitors the operations of participation insurance system in respect of compliance to the participation finance principles and common risk sharing and principles of cooperation*" (Resmi Gazete, n.d.). Then, in Article 8, it clarifies the position in the organizational chart of TO as "*The Committee shall be attached to the company's board of directors*." (Resmi Gazete, n.d.).

Finally, the duties and responsibilities of the institutional level *Shari'ah* Advisory Committee are stated in the Regulation (Article 8):

a) *"To review the company's applicable policies and procedures in respect of the participation finance principles,*
b) *To authorize in order for buying participation reinsurance or reinsurance within the framework of participation finance principles,*
c) *To review the company's investment operations in respect of their compliance to the participation finance principles and to confirm such compliance,*
d) *To consult the company's board of directors and other related departments about the principles and practices of participation finance and participation insurance,*
e) *To be involved in the in-house new product development processes,*
f) *To make comments in the company's annual reports about conduct of company operations according to the participation finance principles,*
g) *To provide necessary information or do necessary works, if requested by the Ministry,*
h) *To fulfil other duties and responsibility imposed by this Regulation".*

Additionally, the same Article 8 regulates the governance of *Shari'ah* Advisory Committee structure and resolutions. Besides, the Article 10 of the Regulation regulates the disclosure and data sharing of the industry. Even though, putting a distinctive effort for regulating the institution level *Shari'ah* Advisory Committee, the coverage of the operating business models is limited. It only covers the *wakalah*, *mudarabah*, and *wakalah-mudarabah* hybrid models. Therefore, the General Directorate of Insurance is widely open for proposals on developing new models for the economy and amending the regulation for better expanding the *Takaful* industry. For this reason, two new fully-fledged *Takaful* companies are officially registered and applied for their licences with modified *wakalah* model with a plan to start their operation soon (Dinç, 2019).

The Turkish Islamic insurance market has difficulties in applying *Takaful* operations. The key lacking point in the regulation is the surplus redistribution methodology that has got a hectic situation in Turkey, even though, it has one specific article on the Regulation. Article 7 considers it as a must to calculate the surplus amount, but the methodology is not given. The reasons behind this are the lack of accounting standards and appropriate insurance software for TOs. There are daily reporting and accounting requirements in *Takaful*, but the current standards depend on monthly basis reporting in Turkey. In order to solve this problem, the effectiveness of IFRS 17 Insurance Contracts standards that will enter into force in 2023 will be useful.

The Procedures and Principles of Participation Insurance Business regulation has a strategic contribution to support TOs with its article which bans *Takaful* window. Window based companies can start their operation by just informing Regulatory and Supervisory Authority. They are subject to the same regulation with full-fledge operators. The period of operation by window-based operators expires on 20 December 2020. This period can be extended by 2 years until 20 December 2022 by the Ministry of Treasury and Finance. The 3-year rule of the Regulation is expected to bring strength to *Takaful* companies in Turkey.

In order to further support the development of Islamic finance and *Takaful* in Turkey, several strategies and initiatives are defined in the 11th Development Plan (SBB, 2019) as well. For instance:

- *"The position of interest-free finance will be strengthened in the country's financial system;*
- *Diversified products and services, as well as human resources, will be developed in the interest-free finance arena;*
- *Various financial instruments and mechanisms will be established to support policy development processes;*
- *Rules and regulations will be developed for the implementation of new business models and windows in order to expand participation banking;*
- *Awareness of the interest-free finance system will be enhanced by providing more information to the public about the functioning of the interest-free finance system and financial products;*
- *An integrated data reporting infrastructure will be established;*
- *A set of regulations will be developed to increase the variety of products and services related to the interest-free finance system;*
- *Platforms based on lease certificate, electronic product certificate or stock portfolio will be developed to carry out commodity Murabahah transactions in Turkey;*
- *The use of lease certificate (Sukuk) issues in the financing of public investments will be augmented;*
- *Regulations will be revised to provide ease of application in the use of asset leasing companies (special purpose vehicles) in issuing lease certificates;*
- *Audit standards for interest-free finance will be developed;*
- *Standardisation of the terminology of instruments and institutions related to interest-free finance will be ensured;*
- *Interest-free finance corporate governance system will be established and aligned with international best practices;*
- *Legislation and institutional structure will be developed to encourage participation insurance (Takaful), and operations will be expanded to address all types of risk groups;*
- *Participation reinsurance (Re-Takaful) fund will be introduced and developed to prevent the flow of national resources abroad."*

Moreover, the 11th Development Plan has set a market share target for Islamic banking as 7% for the end of the Plan period, 2023. This will have a positive effect on *Takaful* industry (SBB, 2019), as *Takaful* is an important component of the Istanbul Finance Centre Plan.

In 2009, the Turkish government revealed its "Strategy and Action Plan for Istanbul as an International Financial Centre". This is to prepare the ground for making of Istanbul a global financial centre by 2023. In order to promote this project, some requirements are needed. They include the improvement of all logistical areas, such as the legal framework and the arrangements for arbitration, and the building of new infrastructures, such as over-the-counter (OTC) derivatives market, specialised commodity exchanges and energy and carbon emission exchanges. *Takaful* is one of the main components of the IIFC project (SBB, 2019).

The Public Oversight Authority in Turkey has recently taken steps to contribute to the development of the Islamic finance industry in 2019. In this context, AAOIFI's management, accounting and auditing standards and ethical principles have been introduced into Turkish legislation. In addition, AAOIFI *Shari'ah* standards have been translated into Turkish language by Istanbul Sabahattin Zaim University in cooperation with PBAT.[15]

Legal and Regulatory Institutions

Turkey remains a leading OIC member country to set the pace for new markets. Turkey had set the ground rules for *Takaful* penetration. From the policy perspective, Turkey would serve as a good case study to examine the implications of policy directions on businesses.

Since Turkey is a secular country, Islamic finance is governed under the existing conventional legislative structure. So, the legal and regulatory institutions are the same for conventional and participation financial institutions. Its legal and regulative structure covers the financial sector in three main groups (banking, capital, and insurance) and for each group there is, generally, only one primary regulator.

The Turkish banking sector is mainly regulated by BRSA. According to the Banking Act No 5411 issued by BRSA, the main function of BRSA is to ensure the implementation of the Banking Act in the Turkish economy. Besides supervising the industry, the mission of BRSA is to develop both conventional and Islamic banking sectors by its regulations. As aforementioned in the discussions, BRSA is responsible for all processes between establishments of banks, leasing, factoring, and forfeiting companies and resolutions of them.

Similarly, CMB is the central authority on capital markets regulations. IFIs and instruments are also regulated and supervised by CMB. Like BRSA, the primary function of CMB is to ensure the implementation of Capital Market Act No 6362. Parallel to BRSA, CMB's supervisory mission is supported with developing capital markets by regulations on introducing new institutions and instruments.

The General Directorate of Insurance of the Ministry of Treasury and Finance is principally concerned with monitoring the insurance sector, licensing reinsurance and pension companies, allowing insurance intermediaries, assessing capital adequacy through offsite reports, reviewing insurer technical reserves and financial performance, assessing the financial controls, and initiating the enforcement measures, including those associated with strengthening the

[15] https://www.izu.edu.tr/haberler/2018/09/13/i-slami-finans-ın-temel-kitabı-i-zü-tarafından-türkçeye-kazandırıldı

financial structure of insurers. In practice, the Insurance Supervision Board of the Ministry principally focuses on on-site supervision of insurers and intermediaries as well as other legal entities and individuals operating in the sector. Besides, Ministry of Commerce is responsible for approval for establishment of company and cooperative status. For different insurance policies, there are also certain insurance pools and/or offices in Turkey that regulate the industry.

Besides, all the other sector partners are also common for both conventional and Islamic insurance. The given *Takaful* sector partners in *Table 15* are the same for conventional insurance.

The agents, brokers and banks play a significant role as distribution channel actors for both conventional and *Takaful* insurance. It can be criticized that when the country level insurance pools are considered, the premium sources are not differentiated in the pools whether it is *Takaful* or not. Even insurance sector employees are required to have specific licenses for Non-Life/General and Life/Family insurance in Turkey regardless of whether conventional or Islamic insurance. In addition, the issuers hold the compulsory training for insurance sector employees including *Takaful*. Furthermore, NGOs are also common in Turkey, which means that perhaps soon the *Takaful* industry is expected to be differentiated at some points from the sector with its own union as understood from the country-level strategies.

TABLE 15: *TAKAFUL* SECTOR PARTNERS

Government (Regulator/ Supervisor)	Companies	Intermediaries	Insurance Pools	Offices	Training	NGOs
General Directorate of Insurance	39 Non-life	15.590 Agents	DASK (Natural Disaster Insurance Institution)	MVB (Motor Vehicles Bureau)	ITC (Insurance Training Center)	IAT (Insurance Association of Turkey)
Insurance Supervision Board	23 Life	140 Brokers	TARSIM (Agricultural Insurance Pool)	PMC (Pension Monitoring Center)	TIIW (Turkish Insurance Institute Waqf)	TOBB (The Union of Chambers and Commodity Exchanges of Turkey)
Capital Market Board	2 General *Takaful* + 5 windows	10.392 Bank Branches	ORYM (Extraordinary Risk Management Center)	IIMC (Insurance Information and Monitoring Center)		TÜSAF (Insurance Agents Federation)
Social Security Institution	2 Family *Takaful* + 3 windows		Receivables Insurance (Hermes)	IAC (Insurance Arbitration Commission)		Insurance Experts Foundation Actuary Foundation
Assurance Account	3 Reinsurance		Risk Insurance			
Takasbank (Clearing)			Green Card Health			

Source: Authors' own

Comparison of Regulatory and Supervisory Frameworks

The legal and regulatory environment is separated into two entities in the dual insurance system economies. However, the Turkish insurance market may not be considered as a dual system, since the legal and regulatory environment has one standard insurance act. As can be seen from *Table 16,* the main regulators are servicing the conventional and Islamic insurance sectors.

There is one slight difference for the overall Islamic finance sector that the PBAT is serving only Islamic banking. The most important issue with standard legal and regulatory institutions is the common pools, which do not separate *Takaful* funds from conventional funds. Even so, the policies that have to be followed under national level pools (like liabilities for motor vehicles, agricultural policies) all type of insurance companies are only agents of the pool operator.

TABLE 16: COMPARISON OF REGULATORY AND SUPERVISORY FRAMEWORKS

	Regulator/Supervisor	Self-Regulatory Organisation	Conventional	Islamic
Banking	CBRT		√	√
		SDIF	√	√
	BRSA		√	√
		BAT	√	-
		PBAT	-	√
Capital Market	CMB		√	√
		BIST	√	√
		Takasbank	√	√
Insurance	The Ministry of Treasury and Finance		√	√
		Pools	√	√
		Offices	√	√

Source: Authors

6.3.3. Growth Trends

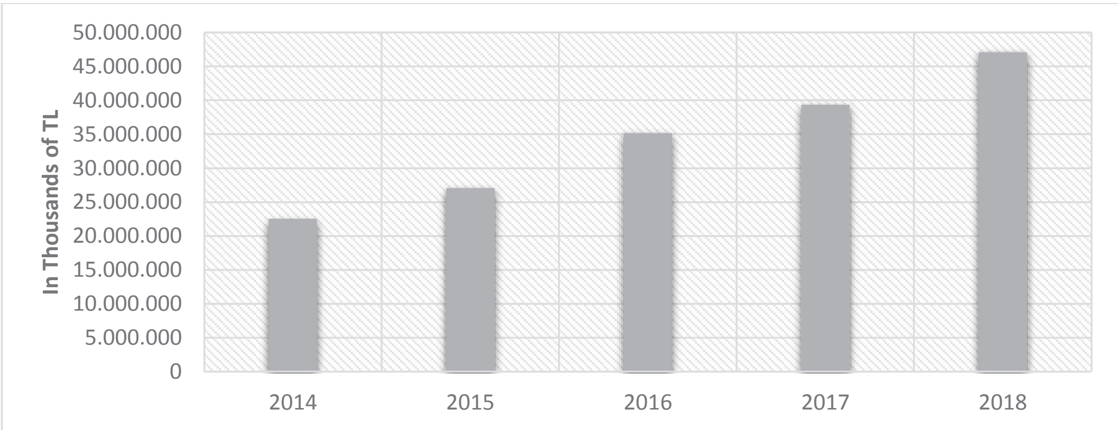
The first General *Takaful* company Neova Insurance was established in the year 2009 and the first Family *Takaful* company Katilim Pension and Life initiated its operations in Turkey in the year 2013. However, the first regulations on *Takaful* came into the picture in 2017 in Turkey. The Regulation on Working Principles and Procedures of Participation Insurance mainly regulate the operating models and the *Shari'ah* Advisory Committee. With such initiatives, there is a significant prospect for success in the growth and development of the *Takaful* sector in Turkey with introduction of new players. Due to the above reasons, the market shares of *Takaful* increased a lot and the *Takaful* sector is picking up momentum. Besides that, *Takaful* is an important component of Istanbul Finance Centre Plan and it will have a positive effect on *Takaful* industry (SBB, 2019).

Despite the newly established *Takaful* companies, the motor *Takaful* segment is one of the most successful. This level’s strategies have encouraged the provision of Islamic insurance products. Turkey has attained a significant level of success in motor insurance. Many firms that did not exist few years back are now major players in the Turkish motor insurance market. According to the Turkish Insurance Association, motor insurance premiums rose by nearly 33% from July 1, 2016, to June 30, 2018 – a rise largely attributed to *Takaful* (Newton, 2019).

Currently, Turkey accounts for four full-fledged insurance companies and eight windows providing *Takaful* coverage for a large section of the population. Experts are expecting that the Islamic insurance (*Takaful*) to reach a 10% share of the Turkish Insurance Market by 2023. There is already confusion over the validity of different *Takaful* contracts, and it is likely that a Turkish option will only further cloud the field. However, Turkey is betting that its solutions, namely growing and empowering a middle class through strong moves with religious backing, could be the key to set it apart from the competitors. By that time, Turkey Takaful practices will likely be considered as best practices. (Atlas Magazine, 2017).

Recent data released by the Insurance Association of Turkey (IAT) (2018) reveals that motor insurance premiums increased significantly by 33% over two years since the mid of 2016. *Figure 21 and Figure* 22 present the growth and size of non-life and life insurance in Turkey.

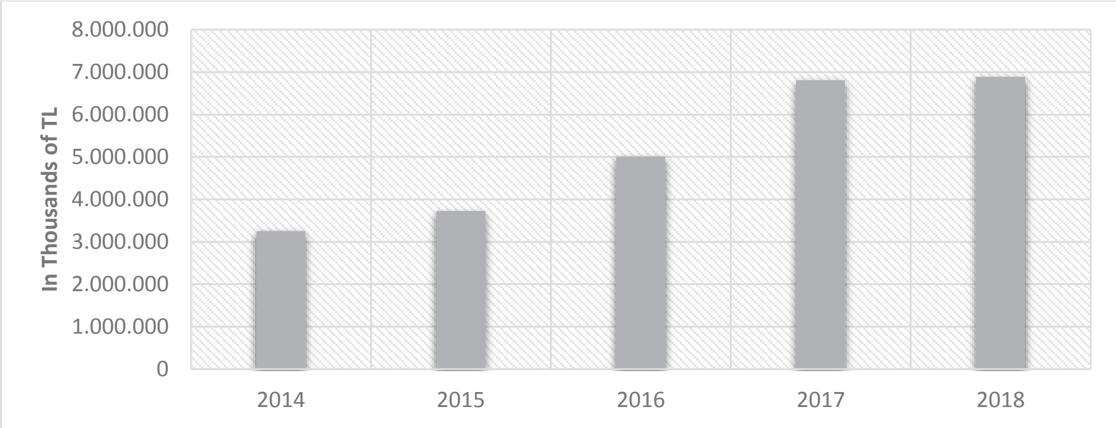
FIGURE 21: THE NON-LIFE INSURANCE OF TURKEY



Source: IAT

Both figures show that there is uptrend growth in both cases. The non-life insurance was only around TRY 22.5 billion in the year 2014, and it was more than TRY 47 billion in year 2018. In the case of life insurance, it was TRY 3.25 billion in year 2014, and it was TRY 6.89 billion in year 2018. It means that both insurance sectors were doubled in year 2018 compared to year 2014.

FIGURE 22: THE LIFE INSURANCE IN TURKEY



Source: IAT

It is believed that such tremendous success is driven by the *Takaful* Sector. Thus, the Turkish economy's share in the world *Takaful* sector is growing fast. The IAT reveals that the total contributions realised from the *Takaful* or Participation Insurance Sector amounted to US$414 million as of end 2018, with four full-fledged *Takaful* companies out of 82 operating in Turkey.

TOs are the key actors in ensuring the sustainability of the overall interest-free financial system in Turkey. It is the most critical pillar to collateralise the financial risks and the necessity of integrating the interest-free financial system. Also Family TOs with their pension plans feed both the Islamic banking, Sukuk market, Islamic index stock companies, and Islamic portfolio management companies. In the conventional system, the insurance mechanism is intertwined with the whole of the financial system at every point and drive economies with their volume as financial actors. Similarly, *Takaful* is developing parallel to the Islamic financial industry, and overall Islamic finance is growing with *Takaful* in Turkey. *Table 17* shows the list of full-fledged *Takaful* companies and windows in the Islamic insurance sector of Turkey.

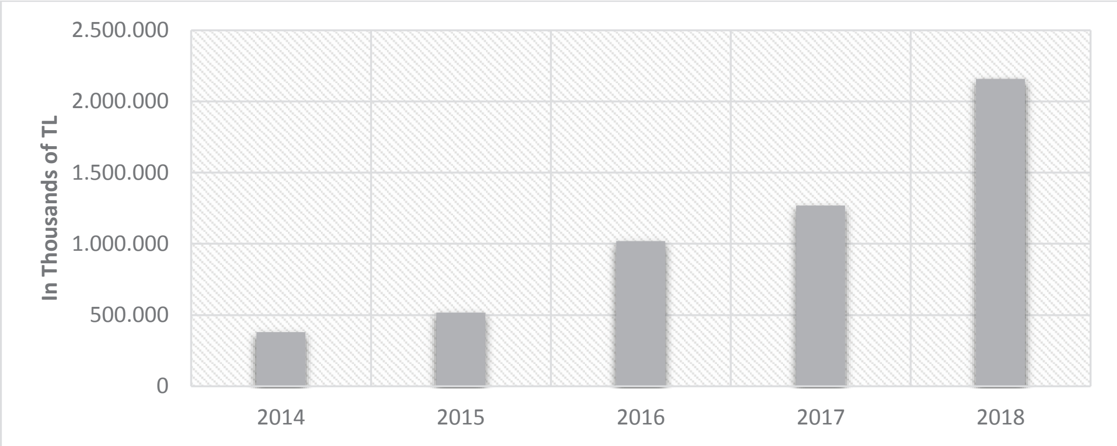
TABLE 17: FULL-FLEDGED *TAKAFUL* COMPANIES AND WINDOWS IN TURKEY AS OF END 2018

Company Name	*Takaful* Type
Neova Insurance	General *Takaful*
Katilim Pension and Life	Family *Takaful*
Bereket Insurance	General *Takaful*
Bereket Pension and Life	Family *Takaful*
Güneş Insurance	Window
Unico Insurance	Window
Groupama Insurance	Window
Vakıf Pension and Life	Window
HDI Insurance	Window
Ziraat Insurance	Window
Ziraat Pension and Life	Window
Doga Insurance	Window

Source: Authors

Figure 23 presents the size and growth of General *Takaful* in Turkey. The size of General *Takaful* was TRY 380 million in the year 2014 and it was more than TRY 2 billion in year 2018. There was 6-7 times increase in year 2018 compared to year 2014. *Table 18* shows that there was notable growth 70.1% in year 2018. The main driver of the growth is entrance of new players in the market. A similar strong growth effect is expected after licencing of the newly registered General *Takaful* company.

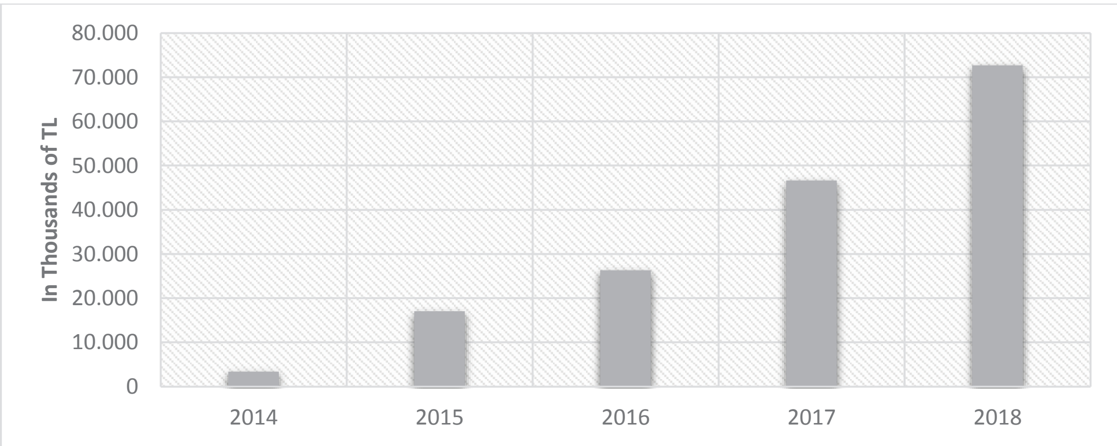
FIGURE 23: SIZE OF GENERAL *TAKAFUL* IN TURKEY



Source: IAT

Figure 24 shows the size of Family *Takaful* sector in Turkey. The Family *Takaful* is relatively small compared to General *Takaful*. The Family *Takaful* was only around TRY3.37 million in the year 2014 while the General *Takaful* was TRY380 million. However, one can see that there was a sizable growth in Family *Takaful* reaching more than TRY72 million by year 2018. The newcomers have positive effect on growth of Family *Takaful* sector; similarly, it is expected to grow faster once the newly registered Family *Takaful* companies (after licencing) join the market.

FIGURE 24: SIZE OF FAMILY *TAKAFUL* IN TURKEY



Source: IAT

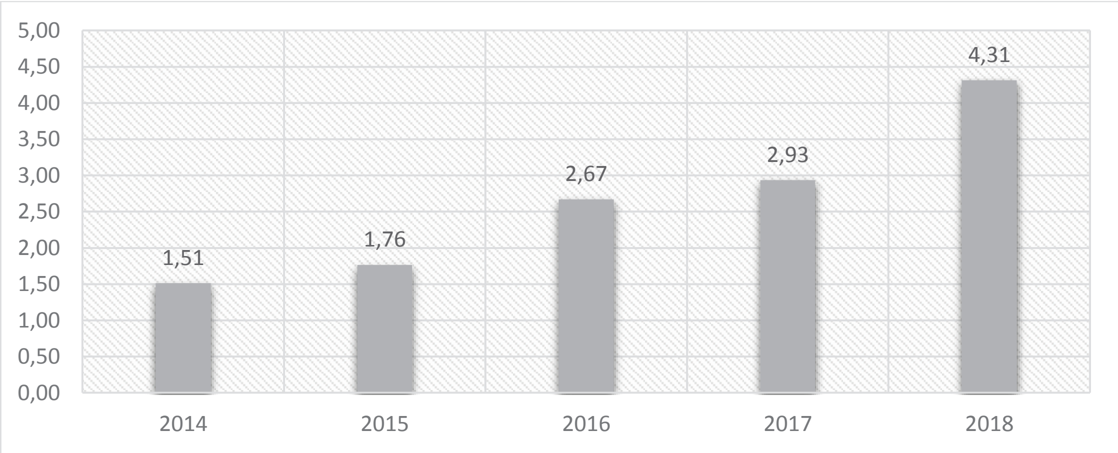
TABLE 18: GROWTH OF GENERAL AND FAMILY *TAKAFUL* IN TURKEY (%)

Takaful Plan	2014	2015	2016	2017	2018
General	35.7	97.5	24.5	20.2	70.1
Family	405.5	54.4	77.1	1.1	55.9
Total	39.0	96.1	25.8	17.4	69.6

Source: IAT

Figure 25 shows the total market share of the *Takaful* sector in Turkey. As of 2018, the share of *Takaful* was TRY2.23 billion while it was only around TRY 383 million in the year 2014. In terms of total market share, it accounted for only 1.51% market share in total insurance sector in year 2014. Then, it substantially increased to 4.31% by year 2018. In a nutshell, these figures indicate that there is a huge potential for *Takaful* sector of Turkey with market acceptance and government support.

FIGURE 25: TOTAL *TAKAFUL* MARKET SHARE IN TURKEY



Source: IAT

6.3.4. The Most Preferred *Takaful* Structures

The most preferred *Takaful* structure in Turkey is *wakalah-mudarabah* hybrid model (see *Table 19).* The diagram is represented in *Figure 8* as a hybrid model.

TABLE 19: LIST OF FULL-FLEDGED *TAKAFUL* COMPANIES WITH OPERATING MODELS

Company Name	Type	*Takaful* Model
Neova Insurance	General *Takaful*	Hybrid
Katilim Pension and Life	Family *Takaful*	Hybrid
Bereket Insurance	General *Takaful*	Hybrid
Bereket Pension and Life	Family *Takaful*	Hybrid

Source: Authors

As mentioned above, the regulation covers only three main models; *mudarabah*, *wakalah*, and hybrid *Takaful* but we have to mention that the Turkish regulatory body is open for other current or new models to regulate. The modified *wakalah* model may fit better to Turkish market dynamics and culture. Turkey has experience in insurance for more than a century (Baskıcı, 2002). Moreover, the sector is experienced for main insurance activities that can generate income from reinsurance refunds, assistance, and recourse which can motivate the operators on their businesses more than *wakalah* fee or investment income shares. The policyholders focus on the quality of service more than the gains on investment, hence compromising on such models as *mudarabah* model as well as the hybrid model. It can be understood from the attitude of the Ministry of Treasury and Finance and from the 11th Development Plan that soon Turkey will become a business model innovation hub for the *Takaful* industry (SBB, 2019).

6.3.5 Issues and Challenges

There are many issues and challenges that stand as obstacles in the way of the development of *Takaful* in Turkey. The following are examples to mention:

- **Global Developments**: Premium inflation caused by the increase of reinsurance costs after the excessive appreciation of the US Dollar with the currency crash.
- **Multinational Companies**: Carrying out the effect of uncertainties arising from local economies.
- **Economic Outlook**: The pressure of financial scarcity on growth in Turkey's economy.
- **Interest Rate**: Economic slow-down caused by a lack of long-term investment because of interest rate fluctuations.
- **Banking Sector Performance**: Negative effect of low performance in the banking sector, one of the main distribution channels for insurance, on policy production and premium volume.
- **Minimum Wage Increases:** Contingency inflation caused by uncorrelated increases in the minimum wage with the growth rate.
- **Verdicts:** Unexpected contingency expenses caused by the court decisions which increase the insurance coverage.
- **Ageing Population**: Increasing contingency expenses caused by social security supplementary products.
- **Legal Regulatory**: Absence of Islamic finance act and central *Shari'ah* board.
- **Taxation**: Lack of proper taxation framework related to *Takaful* underwriting surplus.
- **Academic**: Dearth of academician in every academic sector, especially universities, lack of enough research and publication, insufficient conferences, seminars, and symposiums.
- **Technical**: Absence of *Re-Takaful* industry, accounting standard related to *Takaful*, and main *Takaful* software.

6.3.6 Lessons learned, Recommendations and Transferring Knowledge

One of the most significant lessons in legal and moral philosophy of the Turkish insurance industry is the emphasis on compliance and governance. Another lesson is the strong support of the government with long-term strategies for expanding the market. This is quite important for developing *Takaful* in the country.

Takaful industry in Turkey is showing strong growth. The main driver of the performance is the new entries into the market. It shows that the new players are expanding the market. It is an obvious lesson that new players should be encouraged to invest in the *Takaful* industry.

Recommendations and Transferring Knowledge

- **For governments**: According to the survey undertaken, the market confidence, the political stability, the government support for the *Takaful* industry, the transparency of regulatory framework are very important factors for *Takaful* industry in Turkey. Therefore, it is recommended that the Turkish government should support the *Takaful* industry by giving full support to this new industry.
- **For *Takaful* companies**: Based on the findings of the survey, the quality operation, product development and innovation, financial technology, *Shari'ah* board in *Takaful* companies are in essential factors for the success of *Takaful* companies in Turkey. Therefore, (i) the *Takaful* companies should improve the quality services they provided by innovating new products and services. By this way, *Takaful* companies can attract more customers; (ii) *Takaful* companies have to pay attention to the financial technology which improves the operation of *Takaful* companies in Turkey; iii) it is also recommended that the *Takaful* companies should set up *Shari'ah* Board in their organizational structure so that this Board supervise and advise the *Takaful* operations in Turkey; and iv) Finally, customer awareness is the most crucial one in the case of Turkish *Takaful* market. It shows the importance of educating the customers regarding the *Takaful* business visa many marketing strategies such as advertisement, promotion, talks and among others are crucial success factors in Turkish *Takaful* market.
- **For Regulators:** The results of this survey show that the availability of *Shari'ah* compliant investments and *Re-Takaful* are the key success factors in Turkey. Therefore, the regulatory bodies should develop comprehensive Islamic financial system such as Islamic capital market, Islamic money market, Sukuk, *Shari'ah*-compliant stocks, *Re-Takaful* and among others so that there will be wider Islamic investment universe for investors.
- **For Education Institutions:** According to our survey, the training of agents and brokers is the most important factor in *Takaful* business in Turkey. Put differently, to promote the acceptance of *Takaful* in Turkey, the conducting of training and seminars for *Takaful* agents and brokers is an important element in *Takaful* business as well. Therefore, it is recommended that education providers should come up with various training and seminars to educate the *Takaful* agents and brokers.

6.4. Case Study: The United Kingdom

6.4.1. Background

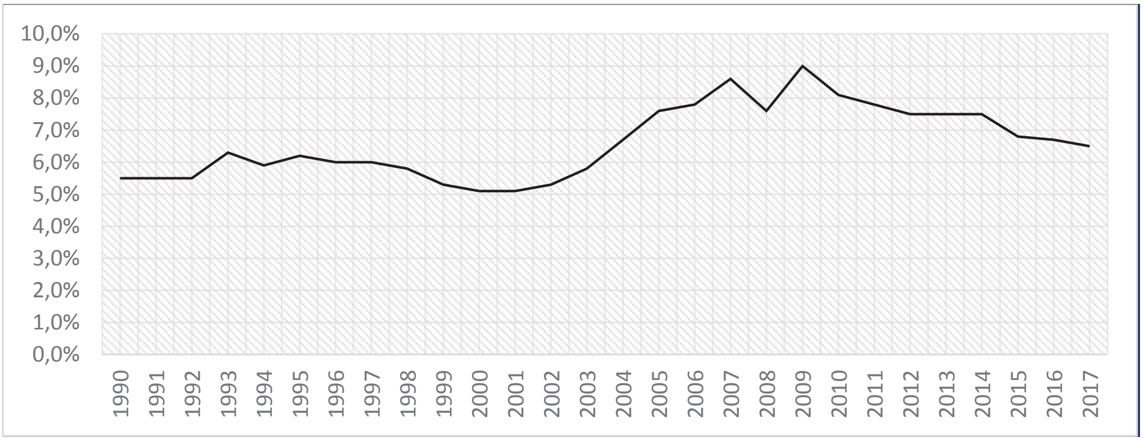
The UK financial sector is considered as one of the world's most efficient financial centres. The global significance of the UK financial sector is seen in key statistics relating to the financial services industry (Rhodes, 2019). The UK economy witnessed a total of GBP 119 billion contributions to it in 2017, which amounted to 6.5% of the total economic output in the country. Being the leading financial centre, London generated about 50% of the financial sector's output. In 2016, among the OECD countries, the UK financial sector was identified as the eighth largest based on its economic output. With a 3.5% of the world's GDP,[16] the UK's insurance spending in 2017 was 12.80% of the total GDP. The national insurance market share of the UK relative to the OECD market is 7.80%. With the UK being the fifth largest economy in the world and considering its ambition to become a global Islamic hub with significant amendments to its financial laws and regulations and further governmental policies to tap into the *Shari'ah*-compliant bonds (Sukuk) market, the UK is chosen as a non-OIC country for the case studies.

According to TheCityUK Report 2019, the UK is still the leading western centre for Islamic finance, in view of its historical role in establishing a level playing field for different financial structures (TheCityUK, 2019). The CBRE Group reported that a significant 44% was invested in London, out of the US$ 13 billion investments of sovereign funds and business from the Middle East. The London Stock Exchange has also attracted a large number of *Shari'ah*-compliant funds and Sukuk. In the year 2014, the UK Government issued its first Sukuk, which were listed on the London Stock Exchange. This was followed by more than 70 Sukuk issuances afterward, with a combined value of over US$ 53 billion (TheCityUK, 2019).

The UK insurance sector provides a unique global centre of high-level expertise for insurance protection for businesses and people across the world. With tax-efficient models, the UK insurance sector focuses on innovative solutions and uncommon commitment to global needs across different geographical divides. The UK insurance sector, when combined with the overall financial services industry, contributed GBP 119.1 billion to the economy. It amounts to 6.5% of the total economic output for the period (see *Figure 26* below).

[16] IMF, "Report for Selected Countries and Subjects – United Kingdom". International Monetary Fund. April 2019. Retrieved 2 May 2019.

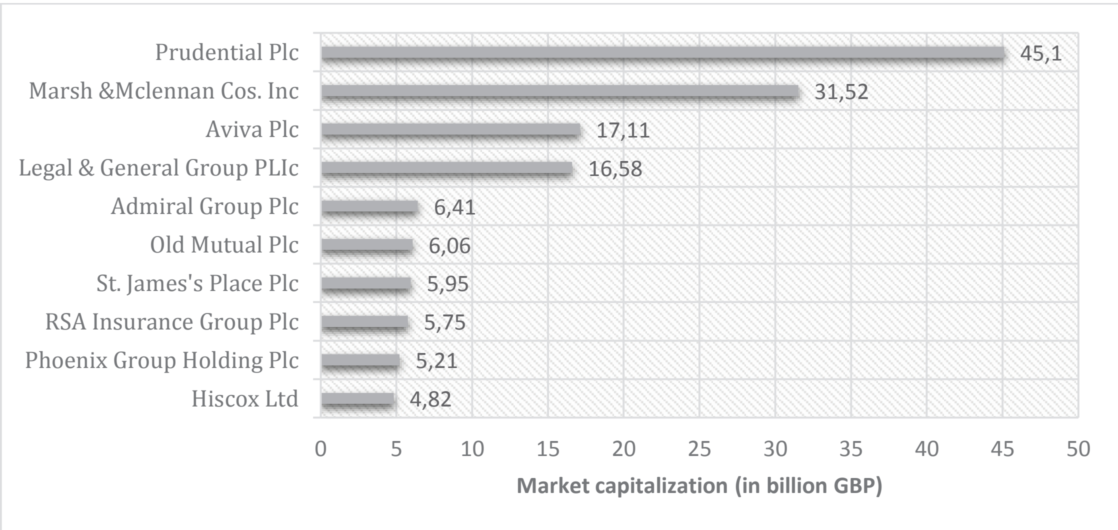
FIGURE 26: FINANCIAL SERVICES ECONOMIC OUTPUT AS A % OF THE UK ECONOMY



Source: Rhodes (2019)

The UK insurance market is considered the largest in Europe and the fourth largest in the world. Apart from the gains recorded in the domestic insurance market, one unique feature of the UK insurance market is its global role as an exporter of insurance to other countries. It has significantly played this historical role as a world leader in exporting UK insurance to the rest of the world. *Figure 27* below shows the leading insurance companies that are trading on the London Stock Exchange as of April 2019. The companies are ranked by market capitalisation in billion GBP.

FIGURE 27: LEADING INSURANCE COMPANIES OF THE UK



Source: Statista

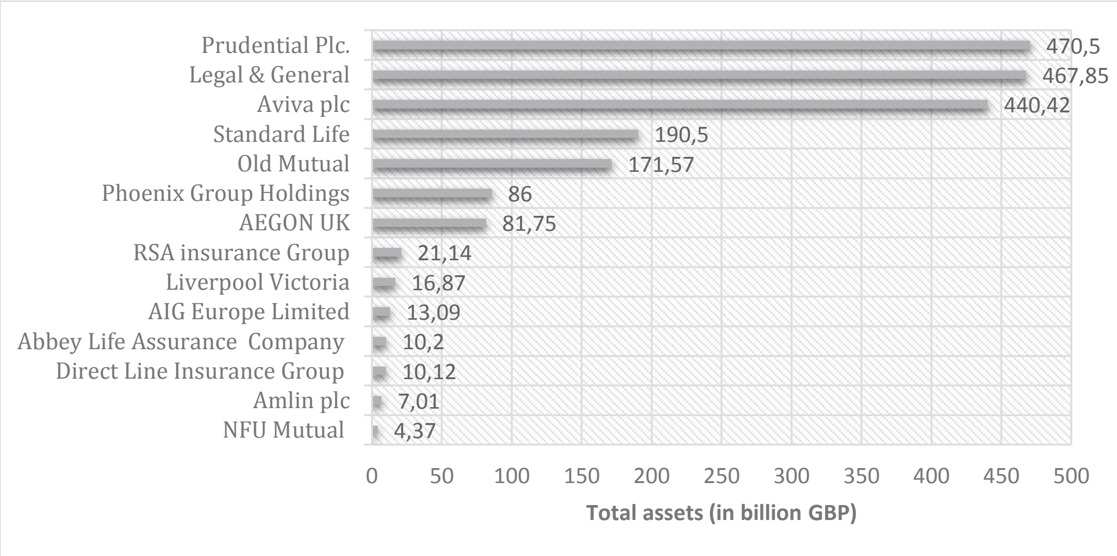
It is seen that Prudential Plc is the leading insurance company, based on its market capitalisation of over GBP 45 billion. It is pertinent to note that Prudential Plc has established its *Takaful* subsidiaries in countries like Malaysia. In Malaysia, Prudential BSN *Takaful* Berhad operates as a joint venture company owned partly by an indirect subsidiary of Prudential Plc of the UK.

In terms of total assets held by an insurance company, Prudential Plc is leading in the UK. As shown in *Figure 28*, in 2016, the total assets of Prudential Plc, which was the largest in the UK, were estimated to be over GBP 470 billion.

Like what is obtainable in most other jurisdictions, the insurance sector in the UK is divided into the two main categories of insurance – life and non-life insurance. Besides these two sectors, specialist insurance is also provided by Lloyd's whose history dates back to the year 1688. For over 330 years, Lloyd's has been providing insurance services to businesses in over 200 countries across the world.

For life insurance, the UK insurance sector underwrote EUR 168.9 billion in 2016, while the whole of Europe had a total life insurance premium of below EUR 700 billion in the same year. On the other hand, in the same year, the UK underwrote over EUR 82 billion of non-life insurance. In the whole of Europe, the share of the insurance market in the UK amounted to over one-fifth of the total market share of the European insurance industry.

FIGURE 28: LEADING INSURANCE COMPANIES OF THE UK RANKED BY TOTAL ASSETS IN 2016



Source: Statista

6.4.2. Legal and Regulatory Framework

In the UK, Islamic finance, generally, has struggled to catch up with centuries-old conventional financial system over the years. Nevertheless, the UK government had projected London as a global hub for Islamic finance, through different initiatives to establish a level-playing ground for alternative finance. For instance, in the year 2014, the UK Trade and Investment (UKTI) which was later moved to the Department of International Trade affirmatively announced that the UK is a centre for Islamic finance since many banks in the country (as of then) offered Islamic finance products and services. Besides, the large professional services providers such as law firms and rating agencies have expert Islamic finance teams serving the global market (GOV.UK, 2014). The strategy adopted by the UK government sought to promote financial inclusion through alternative finance products. This made Islamic finance products and services available to the UK Muslim population, which was expected to contribute to projecting London as an international financial centre catering to the needs of all segments of the population.

The UK Government has introduced proposals and policies to explore how *Shari'ah*-compliant student loans could be introduced. It also published guidance for the market relating to specific requirements for public registration of land purchased through Islamic finance product. Before this, the UK was the first Western non-Islamic country to recognise and allow many aspects of Islamic finance practices and product offerings.

One of such earliest initiatives dates back to the 1980s when the first commodity *murabahah* transaction was conducted through the London Metal Exchange. In 1982, Al Baraka International Bank became the first UK Islamic bank that was licensed in the country. Subsequently, investment banks offered various *Shari'ah*-compliant products to customers in the Middle East, even though they were operating out of London.

Further momentum built up in 2000 when the Islamic finance industry received significant political support and regulatory approval. It culminated in the establishment of an Islamic finance working group, whose membership comprises representatives from the Financial Services Authority, the treasury, financial institutions, members of the Muslim community, and the Council of Mortgage Lenders. The efforts of the working group led to significant policy reforms, one of which related to the need to provide a level-playing field for both Islamic banks and their conventional counterparts. The reforms included the inclusion of clauses relating to Alternative Finance to the Taxation legislation such as the Stamp Duty Land Tax (Exception of Certain Acquisitions of Residential Property) Regulations 2008, which was amended to avoid double stamp duty on *Shari'ah*-compliant mortgages; and the Alternative Finance Investment Bonds (Stamp Duty Land Tax) (Prescribed Evidence) Regulations 2009.

With regards to *Takaful*, there have not been proactive steps by the government to promote this faith-based insurance model. However, the government through the Department for Business, Innovation and Skills explored the possibility of introducing an alternative student finance scheme, specifically for students whose religious beliefs forbid them from taking interest-bearing student loans. A consultation was launched in April 2014 on a draft *Shari'ah*-compliant alternative finance product for such student category. A country-wide survey conducted among the Muslim community and the public in general on the acceptability of the proposed product led to positive feedback. It led to the enactment of the Higher Education and Research Act 2017, which according to its Long Title, makes "*provision about higher education and research; and to make provision about alternative payments to students in higher or further education*." The alternative payments have been structured in the form of *Takaful* and expected to be rolled out in 2019/2020.

The innovative *Takaful* product, which will be the first of its kind globally, is explained below in the case studies section. However, it is important to highlight that the initial survey conducted by the government was all-encompassing as it sought to identify the need to ensure financial inclusion in student loan financing and ascertain the readiness of the Muslim community and the overall finance industry in accepting the proposed model. How the *Takaful* model would work when implemented in 2019/2020 is explained in the relevant section below, but it is worth highlighting that one of the critical questions, that the government wanted responses for, was whether the respondents believe there would be enough demand among students and prospective studies for an alternative finance product that is *Shari'ah*-compliant. Unsurprisingly, an overwhelming majority agreed that the demand is imminent. Out of the total number of respondents, 94% (n=18,600) agreed that the demand is there for such products while a negligible 1% (n=267) said there was no demand for such product.

Going beyond the demand for the product, another critical variable identified is acceptability of the proposed *Shari'ah*-compliant product. The respondents were asked whether students or prospective students who have faith-related concerns about the interest rate element in the traditional loans would accept the alternative being proposed to ensure no student or prospective student is financially excluded from accessing such important education financing. In the responses, 81% (n=16.043) of the respondents agreed that the product would be accepted as an alternative finance product for education financing, while 2% (n=311) disagreed.

National policies on *Takaful* in the UK are not restricted to government policies but also include industry-driven regulatory practices which have influenced the development of the *Takaful* sector. Though the insurance industry in the UK is regulated by the FCA for conduct purposes and the PRA for prudential purposes, the Islamic Insurance Association of London (IIAL) introduced self-regulatory standards to competent the statutory regulation. The IIAL was established in 2015 as an international body to ensure industry practices are taken into consideration in the future regulation of *Takaful* in the UK. Part of the objectives identified by IIAL are:

- To promote its membership and the expertise they can bring to their existing and potential clients across the world
- To provide its membership with a platform to meet, network and have their say on how they wish to shape London as a world-leading provider of Islamic insurance and risk solutions
- To provide an analysis of the development of the broader Islamic financial market and how insurance will and can play a part in that development (IIAL, n.d.).

Against the above backdrop, the IIAL issued its principles for *Takaful*, which was launched by City Minister John Glen MP at Lloyd's library. The principal objective of the IIAL's principles which are based on best practices is to standardise market practices to ensure financial consumer protection with regards to the *Shari'ah* compliance of products being offered in the insurance and reinsurance sectors. It gives some level of certainty to prospective *Takaful* clients as well as reassures practitioners that products offered in the UK are consistent with strict prudential and *Shari'ah* requirements. Max Taylor, who is the Chairman of IIAL, emphasised that "*The Principles have been designed to deliver certainty to both those operating in the market and, more importantly, Islamic clients across the world... It is not only a huge opportunity for London to access new risks, and new markets, but also it has wider implications*." (Reuters, 2018).

Though the new standards are not enforceable as they are industry-level best practices, they provide good guidance for the *Takaful* sector in the UK upon which they will base their negotiations generally. It is not unique to the Islamic insurance sector, as the conventional insurance sector also adopts industry-driven best practices where model products and contracts are developed to guide clients and insurers.

Since the early 1980s when the earliest Islamic banks such as Dar Al-Mal-Al-Islami (DMI) were allowed to open an office in London and later Al-Baraka Bank, the Islamic banks in the UK were regulated under the same law as conventional banks. There was no special regulatory framework for Islamic banks as licences were issued to all under the existing laws. Under the Banking Act 1987, Al-Baraka Bank was issued a licence by The Bank of England to exclusive Islamic banking services in the UK. Al-Baraka Bank opened two branches in London in 1988 and 1988 respectively and subsequently opened another branch in Birmingham in 1991. Due to regulatory compliance issues, Al-Baraka Bank had to close its doors and returned its banking license to BOE in June 1993 even though it continued its operations as an investment company (Housby, 2013). Furthermore, the United Bank of Kuwait also introduced the *Shari'ah*-compliant home financing product branded as *manzil,* with its branch established in the UK in 1997. It was initially transacted through a *murabahah* product, and later in 1999, it introduced the *ijarah* (lease) mortgage option (Housby, 2013).

The above early experiments of Islamic financial products and services were made under prevailing legislation without any specific efforts to provide a level-playing field for both Islamic banks and their conventional counterparts. However, the UK government later realised the need to deepen this nascent industry by exploring some legal and regulatory reforms. The main objectives of this were to promote London as an international financial centre and ensure financial inclusion domestically. To ensure proper industry-specific policies, laws and regulations are provided, several consultative bodies were constituted. In 2001, the BOE established the Islamic Finance Working Group. Similarly, in 2003, the HM Treasury and HM Revenues and Customs established a Tax Technical Group, and in 2007, the HM Treasury Islamic Finance Experts Group was established. In 2011, the UK Islamic Finance Secretariat (UKIFS) was formed, and 2013 witnessed the establishment of the ministerial-led Islamic Finance Task Force (IFTF) (GOV.UK, 2014).

Despite the uncertainties in the Brexit negotiations, the UK had introduced specific reforms in the legal and regulatory framework for the finance industry to accommodate Islamic finance. Generally, the facilitative approach has been adopted to allow for a level-playing field for Islamic finance to ensure financial inclusion through amendments to existing laws. For instance, to prepare the framework for the issuance of Sukuk, the Alternative Finance Investment Bonds (Stamp Duty Land Tax) (Prescribed Evidence) Regulations 2009 was issued. Similar alternative finance clauses have been introduced in other taxation legislation. In the Islamic banking sector, the major challenge in countries like the UK is the issue of double taxation, which was also resolved through legislative amendments to existing laws, including the Finance Act 2003. Tin addition, the Finance Act 2005 identifies Islamic finance as "alternative finance arrangements", with substantial clarity on the definitions of each Islamic finance mode of financing in the legislation.

In 2010, the Finance Act 2005 of the UK was amended and the relevant provisions applicable to "alternative finance arrangements" were repealed and moved to different legislation for legislative clarity and to avoid duplication of laws. In other words, sections 46-47A of the Finance Act 2005 were abolished, and the provisions were substantially moved to Taxation (International and Other provisions) Act 2010, Schedule 2 which is on alternative finance arrangements, which provides: "In this Part "alternative finance arrangements" means— (a) purchase and resale arrangements, (b) diminishing shared ownership arrangements, (c) deposit arrangements, (d) profit share agency arrangements, and (e) investment bond arrangements. The implication of the latest amendments is to ensure there is no double taxation for alternative finance arrangements while still subjecting Islamic finance to existing legislation regulating the financial services sector.

Just like other aspects of the Islamic financial services industry in the UK, the *Takaful* sector is regulated under the existing legal and regulatory framework for insurers and reinsurers. The insurance industry, as well as the *Takaful* sector, are governed by the Financial Services and Markets Act 2000 as amended, and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. The Financial Conduct Authority introduced a Handbook while the Prudential Regulation Authority issued its Rulebook to expressly state the governance and capital requirements of insurance companies in addition to business requirements.

With Brexit negotiations, uncertainty looms in the air as to the need for the UK to have its specific legislation on certain aspects of insurance. However, the latest amendments to the Taxation (International and Other provisions) Act 2010 provides a general framework upon which *Takaful* contracts can be structured. Hence, the above section would apply to *Takaful* contracts. In addition to this, the recently introduced *Takaful* model for student financing is underpinned by relevant provisions in the Higher Education and Research Act 2017, which recognises alternative payments which do not bear interest.

It is pertinent to note that under the UK legislation, there is no explicit definition of insurance or reinsurance contract; hence, *Takaful* is not defined anywhere. However, reliance is placed on the essential requirements of an insurance contract enumerated by Channell J in *Prudential Insurance Co v IRC* [1904] 2 KB 658, where he identified that an insurance contract constitutes the payment of a sum of Money called, which may be called premiums by a party (i.e. policyholder). In consideration of such payments, the other party (the insurer) contractually undertakes to indemnify the first party upon the occurrence of a certain specified event. Such specified event must be adverse to the interest of the policyholder. Furthermore, in *Hall D'Ath v British Provident Association* [1932] 48 TLR 240, the court held that the profit motive is a cardinal element in an insurance contract. These general principles established can be transposed to a *Takaful* contract since all elements of a typical Islamic contract can be identified therein.

The *Takaful* sector in the UK has continued to suffer the same fate as the *Takaful* sectors in other major financial hubs across the world. *Takaful* has not picked up enough pace like other sectors of the Islamic financial services industry, such as the banking and Sukuk sectors (D'Alvia, 2017). Despite its premier position as the leading global financial centre, the UK's experiment of *Takaful* has been a mixed bag of successful and failed initiatives. For instance, in July 2008, there was an initiative to introduce the first *Shari'ah*-compliant insurance company in the UK. It was offered by the British Insurance Company, which was known with the trade name: Salaam *Takaful* or Salaam Halal Insurance. After a year in business, Salaam *Takaful* had to be closed as a result of non-patronage and low business turnover.

Unlike the Salaam *Takaful* experience, a unique model of *Shari'ah*-compliant insurance was introduced in the London market in 2012 (D'Alvia, 2017). The new model was introduced by Cobalt Underwriting Services, whose uniqueness is seen in its business model. Through common management, the Cobalt platform allowed some insurance firms to offer *Shari'ah*-compliant products through *Takaful* windows. The Cobalt platform, trading as Cobalt Underwriting, relies on several insurers and reinsurers across different jurisdiction.[17] Its market focus is the commercial business in the global market with significant success over the years. Its products include marine and trade credit, financial and professional risks (including financial institutions), property, construction, and casualty. The Cobalt Underwriting is considered as the world's first underwriting agency which provides *Shari'ah*-compliant insurance and reinsurance covers to clients across the globe.

The success recorded by Cobalt Underwriting, the continuous product development initiatives by key players in the UK market and the significant paradigm shift towards FinTech inspired a home *Takaful* model introduced in 2017. The FinTech-driven model is called InsureHalal which looks very enterprising considering the technology it adopted in implementing its model. However, the *Takaful* policies of the participants are underwritten by LAMP Insurance Company, which unfortunately went into liquidation recently.[18] As of 31 May 2019, LAMP Insurance Company has entered into liquidation. It again smacks of reputation risk for TOs in the UK.

[17] Cobalt Underwriting (n.d.). Retrieved from: https://www.cobaltuw.com, accessed on: 29/08/2019

[18] Insure Halal (n.d.). Retrieved from: https://www.insurehalal.com/, accessed on: 29/08/2019

6.3.3. Case Studies

The development of *Takaful* in the UK and the experiments over the years is a mixed bag of both successful and unsuccessful initiatives. Hence, this case studies focuses on two successful models: Cobalt and *Takaful* Alternative Student Finance.

Model 1

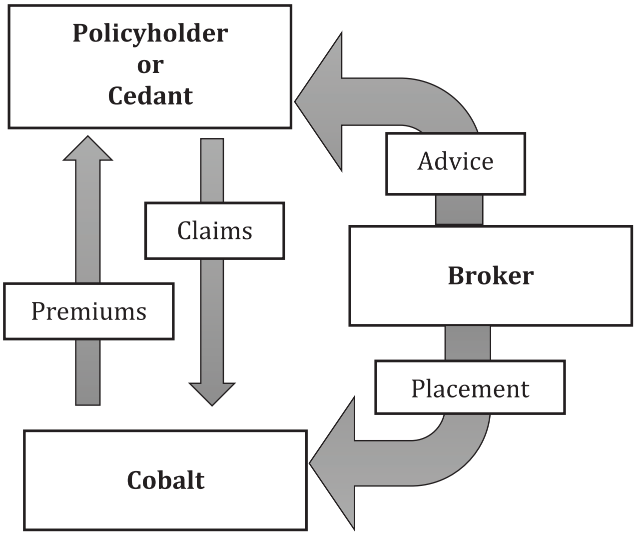
Cobalt Underwriting

In 2012, Cobalt Underwriting was established in London as a *Shari'ah*-compliant underwriting agency. It is a cover holder of Lloyd's and launched its first product in 2013. While operating out of London, Cobalt offers *Shari'ah*-compliant products and services to support different forms of activities across the world. Some of the services provided by Cobalt include providing a platform for surplus sharing, *Shari'ah* compliance assurance, development of *Shari'ah*-compliant investments. It was recently announced that Cobalt enabled the distribution of surplus to charity. Chaucer Syndicate operates a *Takaful* window through the services provided by Cobalt, and it consequently announced that it donated a surplus of GBP4,700 (US$ 5,851.47) to the Teenage Cancer Trust in London. The surplus emanated from its operations during the first year of 2015 (IFN, 2019).

Cobalt is regulated by the Financial Conduct Authority and also has its self-imposed *Shari'ah* Supervisory Board with an additional in-house scholar. Cobalt does not carry any risk but provides underwriting agency services through London-based insurance companies who operate Islamic "windows". The Cobalt model is not the typical retail *Takaful* available in Muslim-majority countries. While the structuring of the model is based on all relevant *Takaful* principles, this unique model is a syndicated placement format which is well known in the London subscription market. It is adequately structured not to only comply with the *Shari'ah* principles but to also comply with specific regulatory and prudential requirements.

As illustrated in *Figure 29*, the Cobalt model involves the payment of premiums by contributors, which are paid directly to Cobalt. However, the broker can pay on behalf of the client if he has a *Shari'ah*-compliant bank account. As for claims, they are submitted to Cobalt who reviews them before making the settlement as per the policy conditions. One unique practice in Cobalt, which is not found in the main *Takaful* financial centres is the *Shari'ah* verification of claims made by contributors. This review is made to ensure the claim itself does not contract any principle of the *Shari'ah*. Claims are not settled through brokers but paid directly to the contributors or cedant. Brokers are paid a fee or commission, which is recognised under the *Shari'ah*.

FIGURE 29: COBALT *TAKAFUL* MODEL



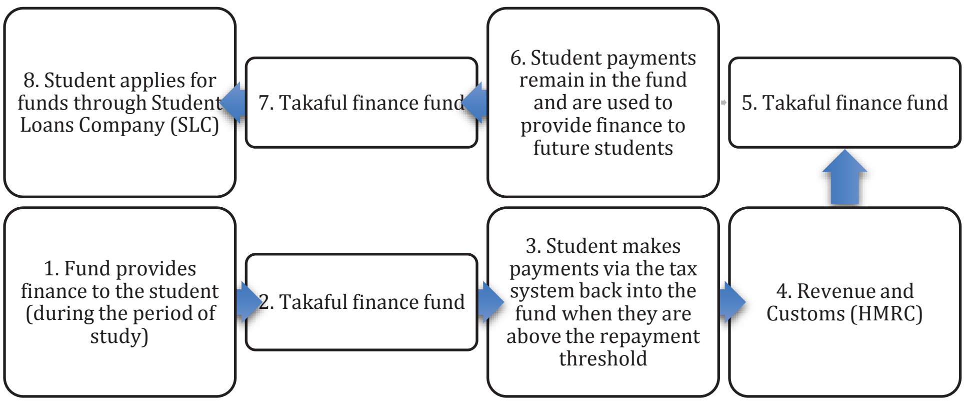
Source: Cobalt (2014)

Model 2

Takaful Alternative Student Finance

The *Takaful* Alternative Student Finance (TASF) model is a unique product backed by legislative intervention in the UK and ready to be rolled out to students in 2020. In 2012, the UK government, through a survey, sought the views of major stakeholders in the UK and beyond to provide *Shari'ah*-compliant student loans for Muslims. It is meant to promote financial inclusion, particularly to avoid a subtle exclusion of those who are averse to interest-bearing student loans due to their religious beliefs. After a series of exploration, the final model which has gone through necessary *Shari'ah* filters is presented in *Figure 30.*

FIGURE 30: THE STRUCTURE OF *TAKAFUL* ALTERNATIVE STUDENT FINANCE



Source: Adopted from Alamad (2019)

It is pertinent to briefly analyse how this ground-breaking model will be utilised for *Shari'ah*-compliant student loan financing. The TASF is expected to be established by the Department for Education as an independent entity which is ring-fenced from the current student loan system. After the creation of the independent body, the HM Treasury provides the funding to the TASF entity based on *qard hasan* or interest-free loan. The TASF then appoints the TO which may be the Student Loans Company (SLC) to administer the funds utilising the *wakalah* model or service agency agreement for a fee. Therefore, while using the same platform, the SLC would provide services relating to student loans.

6.3.4. Lessons Learned, Recommendations and Transferring Knowledge

As a global financial centre, the UK has substantially put in place the required legal and regulatory framework which are underpinned by policies of the government to ensure the insurance and reinsurance industry remains robust amidst global uncertainties. As demonstrated above, the existing legal and regulatory framework for insurance and reinsurance applies to *Takaful* companies and products. However, there is a need to incorporate alternative insurance models into the existing legislation such as the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 to reflect *Takaful* models. It may fit perfectly into the Schedule of the subsidiary legislation. The Financial Conduct Authority's Handbook did not expressly recognise *Takaful*. This aspect may be incorporated into the Handbook as many conventional insurance companies are expected to roll out insurance policies for the *Takaful* Alternative Student Finance, which will be implemented across UK universities in 2020. The value proposition provided by *Takaful* which offers some benefits of mutual assurance where participants share surpluses may help to disrupt the current insurance industry. It is where experts in product development are required to develop *Takaful* products that are not only *Shari'ah*-compliant but also conventionally competitive.

Having a robust and legal regulatory framework for *Takaful* in the UK will better enhance its status as a global financial centre where UK *Takaful* companies may be servicing the whole world through subsidiaries and branches across the Muslim world. To ensure this competitive edge sees the light of the day, *Table* 20 presents the issues identified and policy recommendations to ensure the *Takaful* sector in the UK insurance industry does not continue to suffer from its dark past.

TABLE 20: ISSUES AND POLICY RECOMMENDATION FOR THE UK

	Issues	Recommendations	Implementing Authority
1.	**National Policy**		
	• Apart from the *Takaful* Alternative Student Finance, the UK has not projected the *Takaful* sector as a prime policy of the government as it did in the Sukuk sector.	• Take relevant step to promote *Takaful* as part of the general policy of financial inclusion in the UK.	• Relevant government ministry
	• As an international financial centre, the UK has not been exporting its *Takaful* models to other jurisdictions as it has done in the conventional insurance sector.	• To support *Takaful* initiatives, including the efforts of the Islamic Insurance Association of London (IIAL) in projecting London as a global financial centre.	• Relevant government ministry and IIAL
2.	**Legal and Regulatory Framework**		
	• There are no relevant provisions on *Takaful* or alternative insurance arrangements in the Financial Services and Markets Act 2000 and Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.	• Relevant provisions should be introduced into the laws to reflect alternative insurance arrangements. Since tax issues may still evolve in some *Takaful* models, and there is a need to level the playing field.	• Relevant government ministry
	• Prudential standards and *Shari'ah* governance need to be tailored to the UK *Takaful* needs	• Since the Bank of England is a member of the Islamic Financial Services Board, there is some scope for the adoption of best practices in *Takaful* and *Re-Takaful* sector in the UK	• Bank of England, Financial Conduct Authority, Prudential Regulation Authority, IFSB
3.	***Takaful* Operators and Product Development**		
	• Since some early experiments of *Takaful* in the UK failed, there has not been many efforts on product development.	• There should be proactive measures towards product development to ensure *Takaful* products are not only seen as *Shari'ah*-compliant but are conventionally viable and competitive.	• TOs and IIAL
	• The education *Takaful* model in a secular environment known as *Takaful* Alternative Student Finance will serve as a good model for other Western countries.	• Other jurisdictions, including OIC countries, may introduce such education *Takaful* for student financing.	• OIC member countries

Source: Authors

6.5 Analysis of Survey Results

This section presents and analyses the results of the survey responses from four countries, namely Malaysia, Saudi Arabia, Turkey and the UK. These four countries vary in their market structures, levels of the development of the Islamic finance industry and the *Takaful* sector in particular, and the legal frameworks. The study conducted two types of surveys to collect the primary data on *Takaful* development: structured online questionnaires and semi-structured interviews.

6.5.1. Analysis of Questionnaires

To comprehend the contemporary *Takaful* scenario of selected countries, we have distributed a questionnaire to *Takaful* industry players, regulators, *Shari'ah* scholars, and academicians via an online platform. The questionnaire includes the following sections: (i) Background information, (ii) Challenges facing the *Takaful* industry, and (iii) Company-level SWOT analysis.

(i) Background Information

The questions in this section of the survey questionnaire were concerned with soliciting the background information of the respondents in the four countries in relation to their areas of specialisation and country of residence. The following six options were identified for the areas of specialisation or occupation: *Takaful* industry player, *Shari'ah* expert, IT professional, Regulator, Academician/Consultant and Others. The first three categories of respondents are internal players of a *Takaful* company, while the rest are external players. Meanwhile, there were four choices for the country of residence category: Malaysia, Saudi Arabia, Turkey and the UK. *Table 21* presents the list of respondents with their specialisation in the sample of countries:

TABLE 21: DISTRIBUTION OF SURVEY RESPONDENTS (QUESTIONNAIRES)

Respondents	Malaysia	Saudi Arabia	Turkey	United Kingdom	Total
Takaful Industry Player	16	6	49	-	71
Shari'ah Expert	6	4	1	1	12
IT Professional	-	1	-	-	1
Regulator	4	1	12	-	17
Academician/Consultant	22	8	6	2	38
Others*	15	7	3	2	27
Total	**63**	**27**	**71**	**5**	**166****

Note: * includes the financial analysts, bankers, actuarial experts, and postgraduate PhD students. **The total number of responses was 218, out of which 166 only are complete. *Source: Authors*

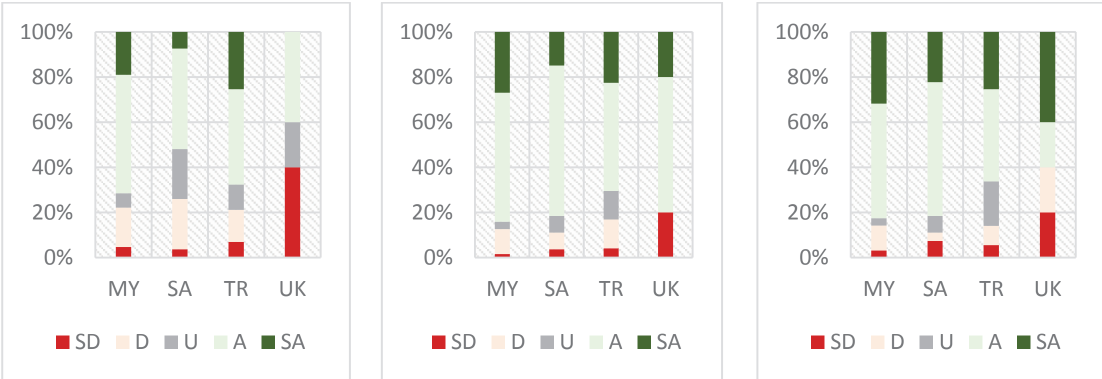
(ii) Challenges Facing the *Takaful* Industry

The questions of the survey in this section solicited the opinions of the respondents on the challenges facing the *Takaful* sector concerning the regulatory and legal frameworks, human capital development, information technology, infrastructure, *Shari'ah* governance, products and services, and business operations. A total of eight questions were designed to represent this section. Each question had multiple options, ranging from three to five options for the various questions.

1) Political and Macroeconomic Environment. In the first question, the respondents in the four countries were asked the extent to which political and economic factors were challenging to the *Takaful* industry in their respective countries. Their responses were based on three options: political uncertainty, macroeconomic conditions and market confidence.

FIGURE 31: POLITICAL AND MACROECONOMIC ENVIRONMENT (SURVEY RESULTS)

(A) Political Uncertainty | (B) Macroeconomic Conditions | (C) Market Confidence

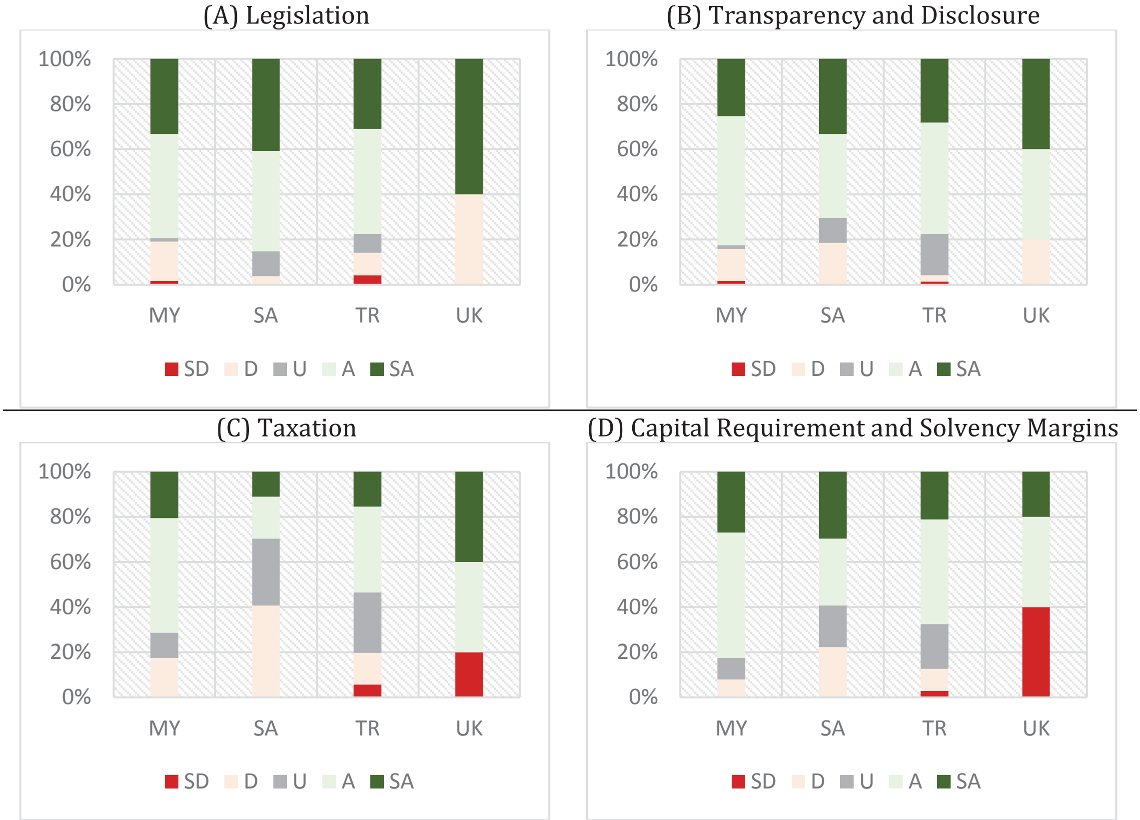


Source: Authors

The majority of the respondents from the three countries: Malaysia, Saudi Arabia and Turkey agreed that political uncertainty is a challenge to the industry while almost 60% of the respondents in the UK disagreed and they feel that political uncertainty pose no challenge to the *Takaful* industry in the country. Meanwhile, most of the respondents, over 65% in all the four countries agreed that macroeconomic conditions and market confidence create challenges for the *Takaful* industry in the respective jurisdictions.

2) Regulatory Framework. The second question is concerned with the extent to which regulatory issues pose challenges to the growth of the *Takaful* industry. Four options were designated for the responses, namely legislation, transparency and disclosure, taxation, and capital requirement and solvency margin.

FIGURE 32: REGULATORY FRAMEWORK (SURVEY RESULTS)



Source: Authors

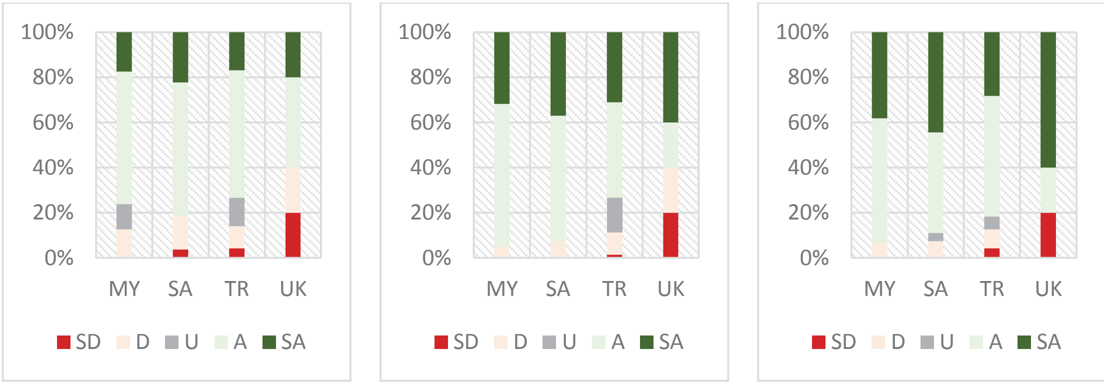
The majority of the respondents from all the four countries: Malaysia, Saudi Arabia, Turkey and the UK agreed that legislation is a challenge to the industry. The response is almost 90% in Saudi Arabia and slightly above 50% in the UK. A similar scenario is observed in the pattern of responses related to transparency where 90% in Malaysia and over 50% in Turkey and the UK agreed that transparency and disclosure are challenges for the *Takaful* industry in the respective jurisdictions.

The majority of the respondents from three countries: Malaysia, Turkey and the UK agreed that taxation is a challenge to the industry. In contrast, only 30% of the respondents in Saudi Arabia agreed that taxation as a challenge. Meanwhile, with regards to capital requirement and solvency margin, the scenario is more or less the same with more than 50% (slightly lower in Saudi Arabia) of the respondents in all the four countries agreeing that these two factors pose challenges to the *Takaful* industry.

3) Business Operations. The third question of the survey solicits opinions on the extent to which fundamental *Takaful* business features pose challenges to the effective growth of the industry. Three options were identified for the responses, namely new business models, quality of operation and, product development and innovation.

FIGURE 33: BUSINESS OPERATIONS (SURVEY RESULTS)

(A) New Business Models (B) Quality of Operations (C) Product Development and Innovation



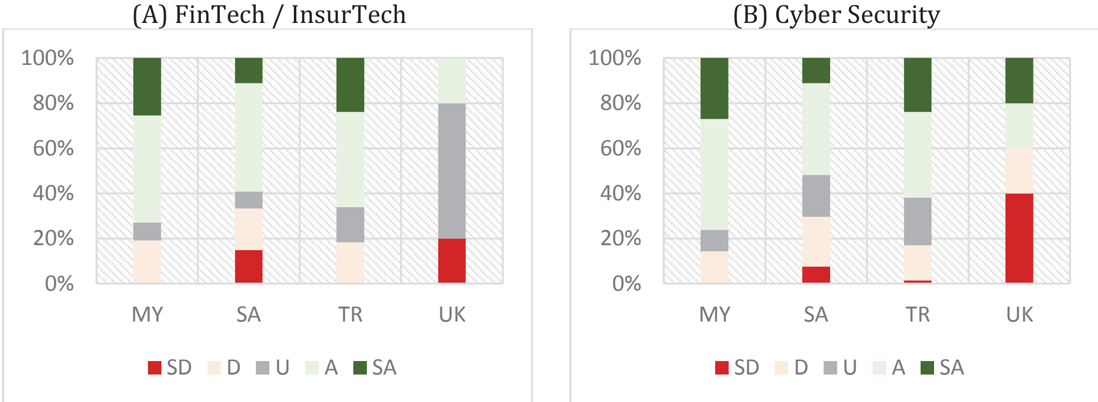
Source: Authors

The majority of the respondents in all the four countries: Malaysia, Turkey, Saudi Arabia and the UK agreed that new business models, quality of operation and, product development and innovation pose a challenge for the *Takaful* Industry. The percentage of responses in the affirmative is higher (over 70%) in the three countries, except the UK. The rate is almost 90% in Malaysia and Saudi Arabia in relation to the challenge of quality of operations as well as product development and innovation.

4) Technology. The fourth question of the survey asked the respondents on the extent to which IT developments create challenges to the growth of the *Takaful* industry. Two options were identified for the responses: FinTech (InsurTech) and Cybersecurity.

FIGURE 34: TECHNOLOGY (SURVEY RESULTS)

(A) FinTech / InsurTech (B) Cyber Security



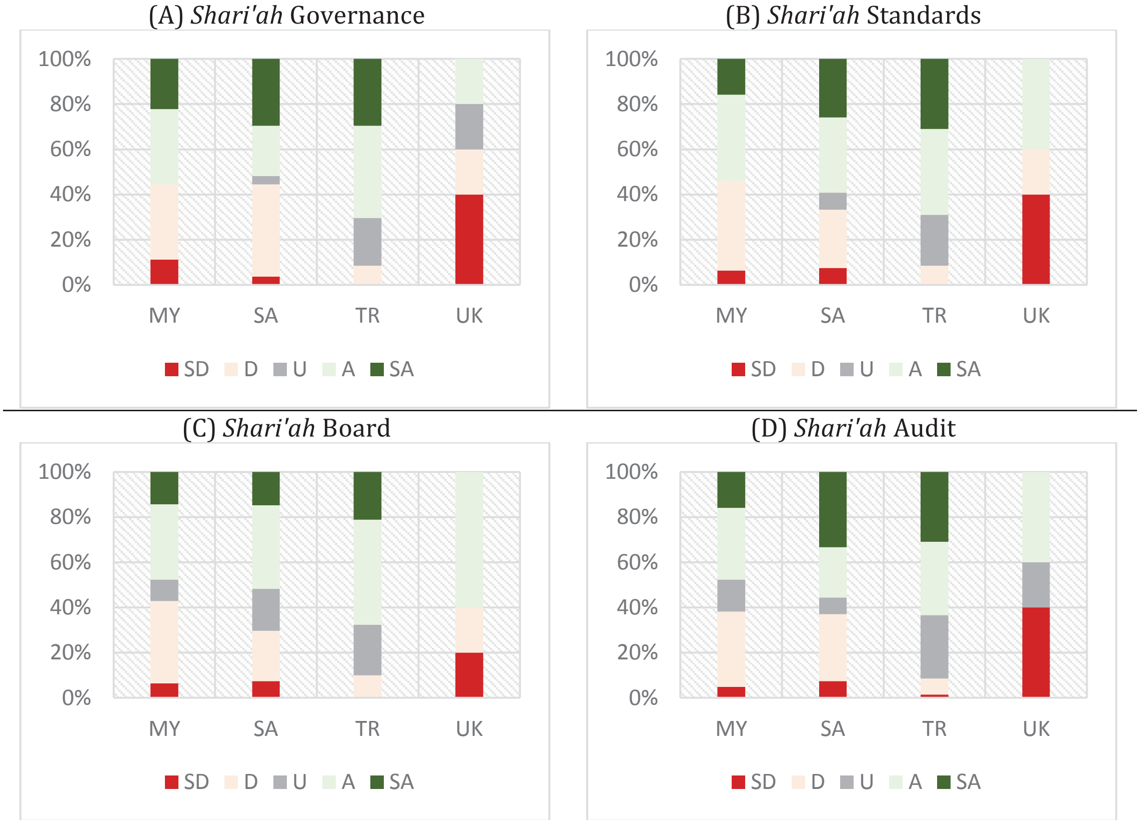
Source: Authors

The majority of the respondents (over 60%) in Malaysia and Turkey agreed that FinTech (InsurTech) and Cybersecurity pose challenges for the *Takaful* industry. The percentage of responses is rather higher in Malaysia (over 75%). In the UK, over 70% agreed that

Cybersecurity is a challenge to the *Takaful* sector. Meanwhile, in Saudi Arabia and the UK (around 40% and slightly over 31%, respectively), the respondents affirm that FinTech (InsurTech) is a challenge.

5) *Shari'ah* Framework. The fifth question of the survey solicited the opinions of the respondents on the extent to which the current *Shari'ah* framework is a challenge to the development of the *Takaful* industry. Four options were identified for the responses: *Shari'ah* governance, *Shari'ah* standards, *Shari'ah* board and *Shari'ah* audit.

FIGURE 35: *SHARI'AH* FRAMEWORK (SURVEY RESULTS)



Source: Authors

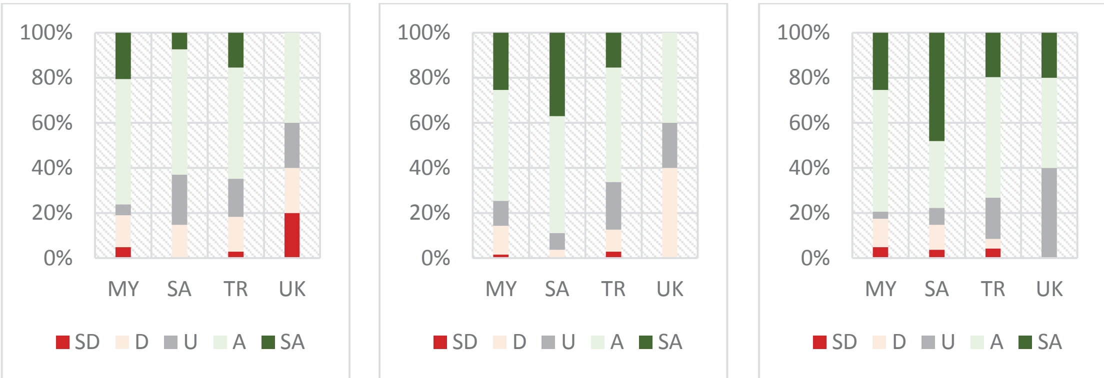
The majority of the respondents: over 50% in Malaysia and over 70% in Turkey agreed that both *Shari'ah* governance and standards pose challenges for the *Takaful* industry. In Saudi Arabia and the UK, over 40% and slightly over 20% of the respondents respectively affirm that *Shari'ah* governance is a challenge. Meanwhile, in the UK, over 40% agreed that *Shari'ah* standard is a challenge to the *Takaful* sector.

The majority of the respondents, over 55% in Malaysia, over 70% in Turkey and over 65% in the UK acknowledge that *Shari'ah* board in their jurisdictions is a challenge to the *Takaful* industry. Only 40% of the respondents in Saudi Arabia see it as a challenge. On the other hand, the majority of the respondents in all the four countries see *Shari'ah* audit as a challenge, with the highest percentage of responses, over 65% in Turkey.

6) Infrastructure. The sixth question of the survey solicited the views of the respondents on the extent to which infrastructure creates a challenge to the growth of the *Takaful* industry. Three options were identified for the responses: distribution channels, availability of *Re-Takaful* services and availability of *Shari'ah*-compliant instruments for investment.

FIGURE 36: INFRASTRUCTURE (SURVEY RESULTS)

(A) Distribution Channels | (B) Availability of *Re-Takaful* Services | (C) Availability of *Shari'ah*-compliant Instruments for Investment

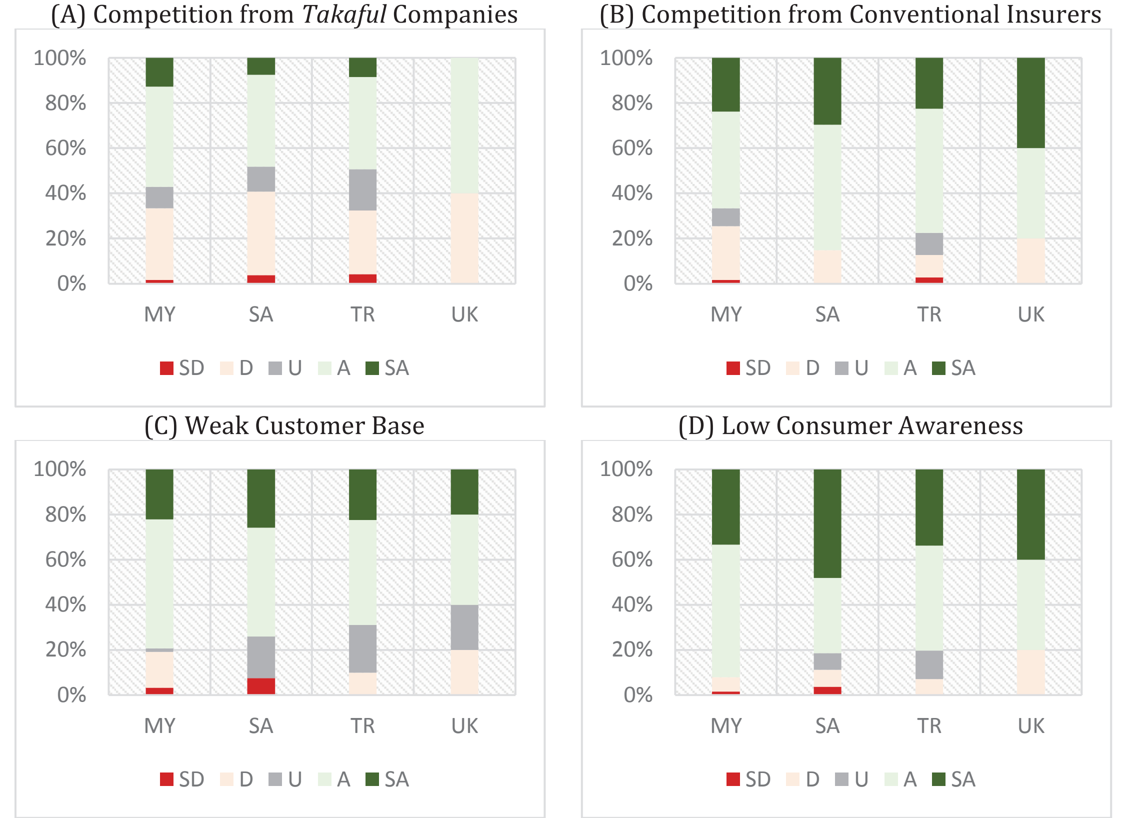


Source: Authors

The majority of the respondents, over 60% in all the four countries, except the UK, agreed that the *Takaful* industry faces challenges in terms of inadequate distribution channels, insufficient availability of both *Re-Takaful* services and *Shari'ah*-compliant instruments for investment. The percentage of respondents are higher in Malaysia, over 80% for the challenges related to inadequate distribution channels and insufficient availability of *Shari'ah*-compliant instruments for investment. In Saudi Arabia, the percentage is high, almost 90% about the challenge of insufficient availability of *Re-Takaful* services.

7) Market. The seventh question of the survey was used to ask the respondents on the extent to which the market forces pose challenges to the development of the *Takaful* industry. Four options were identified for the responses: competition from *Takaful* companies, competition from conventional insurers, Weak customer base and Low consumer awareness.

FIGURE 37: MARKET (SURVEY RESULTS)



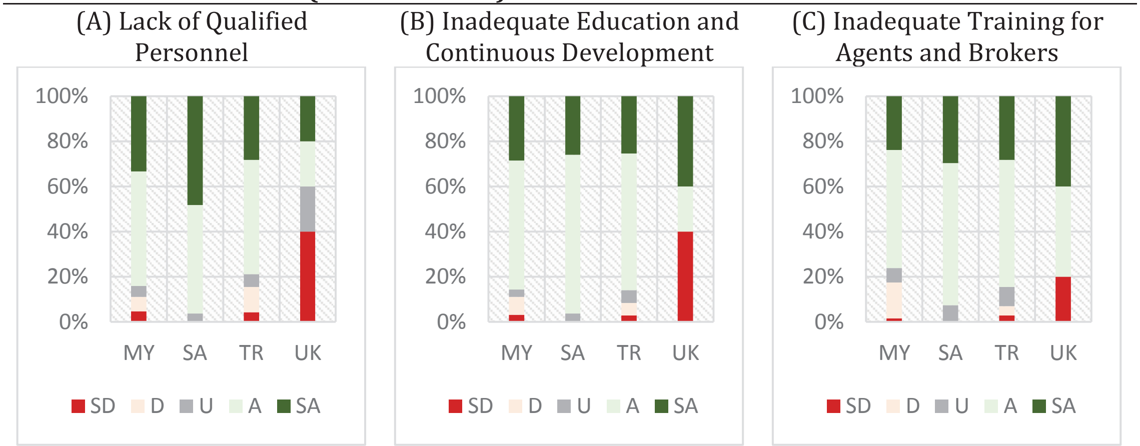
Source: Authors

The majority of the respondents, over 50% in all the three countries except Saudi Arabia agreed that those *Takaful* companies face the challenge of competition among themselves. Similarly, the majority of the respondents: over 60%, over 80%, over 75% and over 80% in Malaysia, Saudi Arabia, Turkey and UK respectively acknowledge that *Takaful* companies face the challenges of competition from conventional insurance in all the four jurisdictions.

The pattern of responses is almost similar for the cases of challenges related to Weak customer base and Low consumer awareness. For example, over 80% of the responses in the Malaysia agreed that the industry faces the challenges of weak customer base and Low consumer awareness. In Turkey, the percentage of responses in the affirmative on the two challenges is over 70%.

8) Human Capital. The eighth question of the survey was concerned about soliciting the opinions of the respondents on the extent to which human capital development create challenges to the growth of the *Takaful* industry. Four options were identified for the responses: lack of qualified personnel, inadequate education and continuous development, and inadequate training for agents and brokers.

FIGURE 38: HUMAN CAPITAL (SURVEY RESULTS)



NOTES: [**MY**: Malaysia, **SA**: Saudi Arabia, **TR**: Turkey, **UK**: United Kingdom]. [**SD**: Strongly disagree, **D**: Disagree, **U**: Undecided, **A**: Agree, **SA**: Strongly agree]. *Source: Authors*

The majority of the respondents, over 60% in all the four countries agreed that the three aspects of human capital development, namely lack of qualified personnel, inadequate education and continuous development and insufficient training for agents and brokers pose challenges for the *Takaful* companies in all the four jurisdictions. Saudi Arabia has the highest percentage of responses, over 90% in two cases and almost 100% in relation to the challenge of inadequate education and continuous development.

(iii) Company Level SWOT Analysis

The questions of the survey in this section are concerned with SWOT (strengths-weaknesses-opportunities-threats) analysis. The respondents were asked to provide their opinions on the strengths, weaknesses, opportunities and threats that their *Takaful* and *Re-Takaful* companies face in relation to developing the industry, enhancing competitive advantage, creating new opportunities and managing threats. A total of four questions were formulated to represent this section. Each question had multiple options. The first question had eight options, the second, third and fourth questions had five options each. In the first question, the respondents in the four countries were asked the extent to which the strengths of their *Takaful* /*Re-Takaful* companies contribute to boost the industry, protect the existing market share and penetrate new markets. The responses were obtained using eight options: use of technology and automation, product development and innovation, customer satisfaction, distribution networks, cash flow, rate of return, skilled workforce and cross country diversification.

1) Strengths. The majority of the respondents (see *Figure 39*), 100% in Malaysia and Saudi Arabia, and over 80% in Turkey have agreed that the strengths of the *Takaful* and *Re-Takaful* companies rely on their use of technology and automation to sustain the quality of services and on successful product development and innovation.

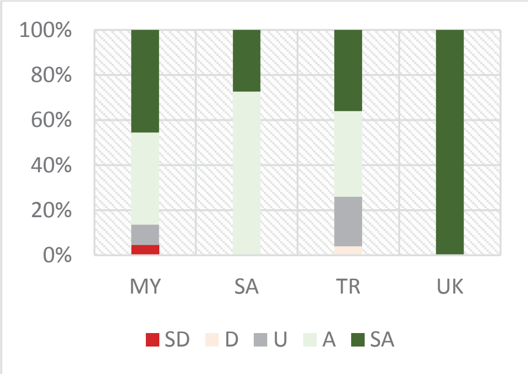
The results presented in *Figure 39* suggest that 100% of the respondents in Saudi Arabia, over 90% in Malaysia and over 80% in Turkey agreed that high level of customer satisfaction and well-developed distribution networks such as dealers and agents are good measures of the strengths of *Takaful* and *Re-Takaful* companies.

100% of the respondents in Saudi Arabia, over 95% in Malaysia and over 75% in Turkey agreed that strong free cash flow for further expansion of projects represent the strengths of *Takaful* and *Re-Takaful* companies. Similarly, 100% of the respondents in Saudi Arabia and over 75% in both Malaysia and Turkey agreed that a steady high rate of return on *Shari'ah*-compliant investments represents the strengths of both companies.

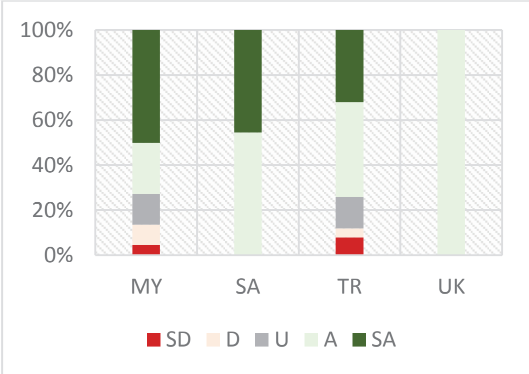
100% of the respondents in Malaysia and Saudi Arabia and over 75% in Turkey agreed that having a highly skilled workforce contributes to the strengths of *Takaful* and *Re-Takaful* companies. Meanwhile, almost 40% of the respondents in Saudi Arabia disagreed that diversification across countries contributes to the strengths of *Takaful* and *Re-Takaful* companies. In contrast, over 60% in Malaysia and almost 80% in Turkey agreed that diversification across countries contributes to the strengths of both companies.

FIGURE 39: STRENGTHS (SWOT SURVEY RESULTS)

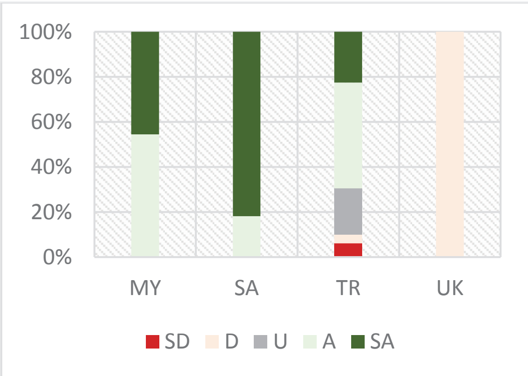
(E) Strong Free Cash Flow for Further Expansion of Projects



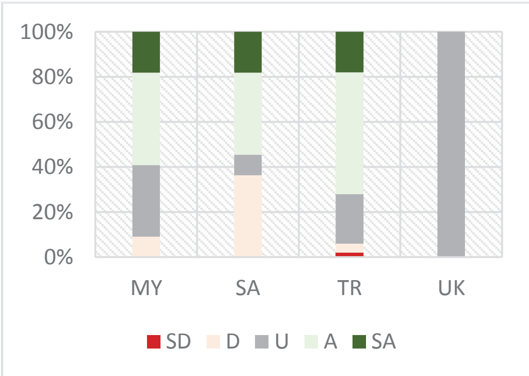
(F) High Rate of Return on *Shari'ah*-compliant Investments



(G) Having High-Skilled Workforce



(H) Diversification Across Countries



NOTES: [**MY**: Malaysia, **SA**: Saudi Arabia, **TR**: Turkey, **UK**: United Kingdom]. [**SD**: Strongly disagree, **D**: Disagree, **U**: Undecided, **A**: Agree, **SA**: Strongly agree]. *Source: Authors*

2) Weaknesses. The second question of the survey questionnaire is concerned about soliciting the opinions of the respondents in the four countries on five options and the extent to which they contribute to the weaknesses of the *Takaful* /*Re-Takaful* companies. These five options are attrition rate in workforce, financial planning, organisation structure, marketing strategies and investment into Research and Development (see *Figure 40*).

Figure 40 shows that over 75% of the respondents in Saudi Arabia and Malaysia and over 50% in Turkey agreed that a high attrition rate in the workforce contributes to the weakness of *Takaful* and *Re-Takaful* companies. Meanwhile, over 60% of the respondents in both Malaysia and Turkey agreed that lack of efficient financial planning contributes to the weakness of *Takaful* and *Re-Takaful* companies.

100% of the respondents in Saudi Arabia, over 90% in Malaysia and over 60% in Turkey agreed that Poor marketing strategies contribute to the weakness of *Takaful* and *Re-Takaful* companies. Similarly, 100% of the respondents in Saudi Arabia, over 70% in Malaysia and nearly 60% in Turkey agreed that Lack of investment into Research and Development (R&D) - below industry average contributes to the weaknesses of both companies.

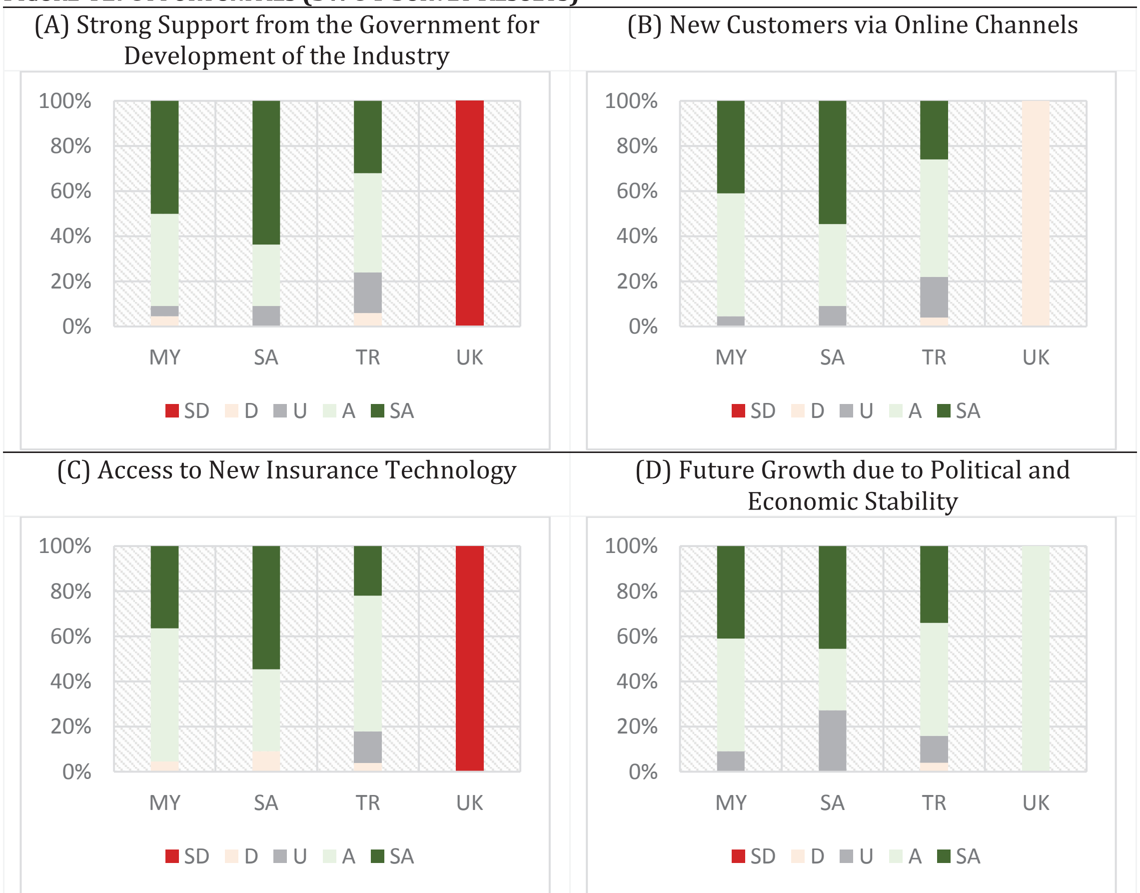
Figure 40: Weaknesses (SWOT Survey Results)

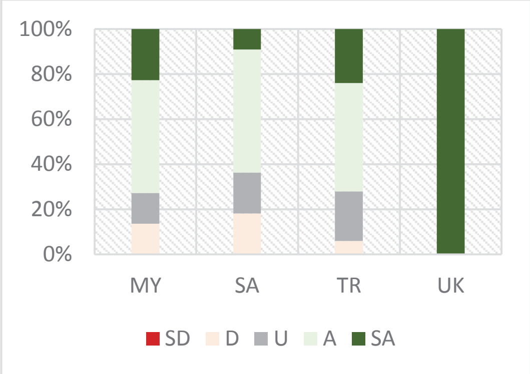
Source: Authors

3) Opportunities. *Figure 41* shows that over 90% of the respondents in Malaysia and Saudi Arabia, and almost 80% in Turkey agreed that strong support from the government provides good opportunity to the growth of the *Takaful* industry. In contrast, 100% of the respondents in the UK disagreed that government support does provide opportunity to the growth of the *Takaful* sector. A similar trend can be seen in the case of the opinions of the experts on attracting new customers online. Over 90% of the respondents in Malaysia and Saudi Arabia, and almost 80% in Turkey agreed that attracting new customers via online channels can be a good opportunity to enhance the growth of the *Takaful* industry. This is contrary to the views of 100% of the respondents in the UK who believe new customers via online channels do not provide opportunity for enhancing the growth of the *Takaful* industry.

Over 90% of the respondents in Malaysia, slightly 90% of respondents in Saudi Arabia, and almost 80% in Turkey agreed that access to new insurance technology creates opportunity for the growth of the *Takaful* industry. In contrast, 100% of the respondents in the UK are of the view that access to new insurance technology does not create opportunity for the growth of the *Takaful* sector. Meanwhile all the respondents in the four selected countries agreed that political and economic stability provide opportunities for the future growth of the *Takaful* industry. The level of agreement varied: 100% of the respondents in the UK, over 90% in Malaysia, over 70% in Saudi Arabia and slightly over 80% in Turkey. Similarly, all the respondents in the four selected countries agreed that cross-border expansion of the *Takaful* business to other countries create opportunities for the *Takaful* industry. The levels of agreement of the respondents are: 100% in the UK, over 70% in Malaysia and Turkey and, over 60% in Saudi Arabia.

FIGURE 41: OPPORTUNITIES (SWOT SURVEY RESULTS)



(E) Expansion in Other Countries	*Notes*:
	**MY**: Malaysia **SA**: Saudi Arabia **TR**: Turkey **UK**: United Kingdom **SD**: Strongly disagree **D**: Disagree **U**: Undecided **A**: Agree **SA**: Strongly agree

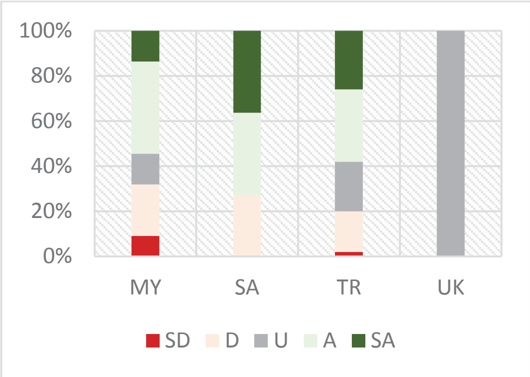
Source: Authors

4) Threats. On the other hand, in the UK, 100% of the respondents are undecided whether intense competition between TOs and conventional insurers is a threat to the *Takaful* industry (see *Figure 42* below). In contrast, over 50% of the respondents in Malaysia, 70% in Saudi Arabia and slightly over 60% in Turkey agreed that competition between TOs and conventional insurers poses threat to the *Takaful* sector. The views vary in the case of new restrictive regulations. Over 100% of the respondents in the UK strongly disagreed that new restrictive regulations are a threat to the *Takaful* industry. On the contrary, over 70% of the respondents in Malaysia, slightly 80% of respondents in Saudi Arabia, and slightly over 70% in Turkey agreed that new restrictive regulations are a threat to the *Takaful* industry.

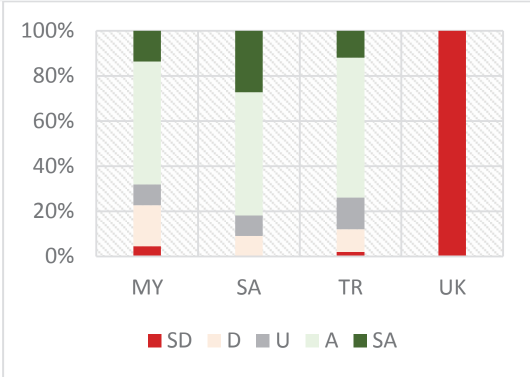
The similar pattern of responses can be seen in the UK regarding inconsistency in developing and supplying new *Takaful* products. 100% of the respondents in the UK agreed that inconsistency in developing and supplying new products poses a threat to the *Takaful* industry. The same view is shared by over 70% of the respondents in Malaysia and Saudi Arabia and over 50% in Turkey. With regards to the vulnerability of cyber security, 100% of the respondents in the UK disagreed that it is a threat to the *Takaful* sector. In contrast, over 90% of the respondents in Malaysia, over 80% of respondents in Saudi Arabia, and almost 60% in Turkey agreed that the vulnerability of cyber security is a threat to the *Takaful* industry. In another SWOT analysis, 100% of the respondents in the UK disagreed that high level of bureaucracy creates impediments to the growth of the *Takaful* industry. This is contrary to the views of slightly over 90% of the respondents in Malaysia, slightly over 80% of respondents in Saudi Arabia, and slightly over 60% in Turkey who agreed that high level of bureaucracy is a threat to the growth of the *Takaful* industry.

FIGURE 42: THREATS (SWOT SURVEY RESULTS)

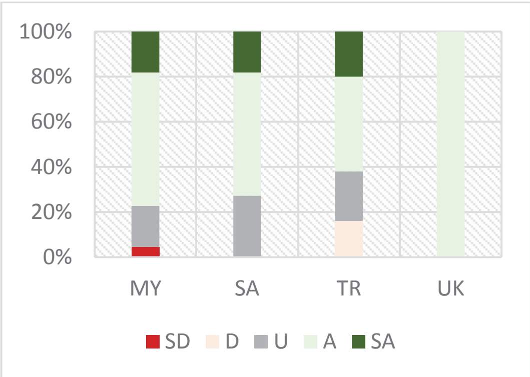
(A) Intense Competition from *Takaful* Operators and Conventional Insurers



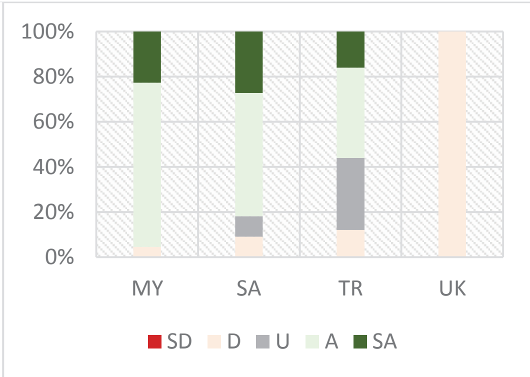
(B) New Restrictive Regulations



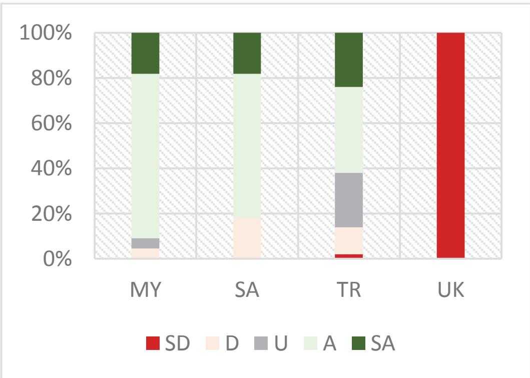
(C) Irregular Development and Supply of New Products



(D) Vulnerable Cybersecurity



(E) High Bureaucracy Level as an Impediment to Growth



Notes:

MY: Malaysia
SA: Saudi Arabia
TR: Turkey
UK: United Kingdom

SD: Strongly disagree
D: Disagree
U: Undecided
A: Agree
SA: Strongly agree

Source: Authors

6.5.2. Analysis of the Interview Results

This section analyses and discusses the results of the interviews conducted with 12 *Takaful* experts from the three countries included in the study: Malaysia [6 experts], Turkey [3 experts] and Saudi Arabia [3 experts]. The twelve experts were asked 10 questions each. The following responses obtained are vital to the development of the *Takaful* industry and complement issues not covered in the survey results discussed above.

1. ***How do the macroeconomic environment, political uncertainty and market confidence influence the Takaful industry and what are the countermeasures that need to be taken?***

   The twelve experts interviewed are unanimous in their views that bad macroeconomic situations coupled with political uncertainties and low market confidence negatively impact consumers' demand for *Takaful* products but investors in such situations will purchase *Takaful* to cover their position. In contrast, good microeconomic environment means high GNP level, high savings and a high potential for *Takaful*. They also believe that political risk can increase the sale of some insurance products although with some extra cost; and well-organized intermediaries, logical price, transparency and disclosure affect the *Takaful* sector positively. Furthermore, they believe that the prospects for growth of *Takaful* sector across markets and regions remain positive, given the series of regulatory initiatives that have been introduced to drive the sector's growth and boost its attractiveness. Experts from Malaysia opine that the good regulatory framework in the country is able to develop confidence in the industry and make consumers feel well protected. Meanwhile experts from Turkey are of the view that Islamic insurance is influenced by trust, which is one of the most important emotional factors rather than real factors.

   In order to enhance the resilience of the *Takaful* industry under challenging macroeconomic environment, political uncertainty and market confidence, the experts suggest the following measures. Firstly, a combination of fiscal and regulatory measures, including tax incentives, the growth of private-sector employment, development of innovative products and distribution strategies to increase the acceptance of and demand for Family *Takaful* products around the globe especially in regions with low Family *Takaful* penetration and relatively small contributions to the total *Takaful* business. This suggestion is based on the fact that of recent the rapid growth recorded in Family *Takaful* for certain jurisdictions is largely fueled by the introduction of products such as bancassurance and tax credits for investments in Family *Takaful*. The experts also suggest that careful attention be given to the following areas: transparency, disclosure, taxation law, solvency, capital adequacy requirements, the credibility of assets in which funds are invested and liquidity ratio.

2. ***How do legislation, transparency, disclosure, taxation, capital requirements and solvency margins play roles in strengthening the Takaful industry and what are the countermeasures that need to be taken?***

Most of the experts (10/12 or 80%) agree that all the areas mention: legislation, transparency, disclosure, taxation, capital requirements and solvency margins play significant roles in strengthening the *Takaful* industry. One of the experts from Malaysia is of the view that all new regulations provided by Bank Negara put customer interest first in terms of transparency and fairness. He also stated that the Malaysian *Takaful* industry no longer uses solvency margin, and instead it uses risk-based capital. He further elaborated that from 2013 Malaysia introduced a new *Takaful* framework, *Shari'ah* governance and Value-Based Intermediation (VBI) under the Islamic Financial Services Act [IFSA 2013]. Nearly 50% of the experts raised the concern that most of the members of the public are unaware of what the solvency margin and capital ratio are and they are not really bothered about knowing them. One of the experts from Saudi Arabia is of the opinion that the *Takaful* industry in most countries is generally weak because the legislation, transparency, disclosure, taxation, and capital requirements and solvency margins in those jurisdictions are not technically in compliance with the *Shari'ah*. Furthermore, he also feels that the conflict of interest with conventional insurance is weakening the *Takaful* industry. In view of these challenges, the experts have recommended the following. Firstly, regulators must give serious attention to the *Takaful* industry to ensure a meaningful reform. Secondly, all the areas mentioned [legislation, transparency, disclosure, taxation, capital requirements and solvency margins] if seriously practised can positively strengthen the *Takaful* industry. For example, it is easier to apply solvency margins, which will be lower for *Takaful* as all risks are borne by policyholder’s fund and hence no liability is put on the company’s finances.

3. ***How can product development, innovation, new business models, and Quality of operations play roles in the growth of the Takaful industry and what are the countermeasures that need to be taken?***

Nearly ninety per cent of the experts agrees that all the areas mentioned above [product development, innovation, new business models, and quality of operations] play positive roles in the growth of the *Takaful* industry. The six experts from Malaysia stated that in order to achieve good product development, innovation, new business models, and quality of operation *Takaful* companies must significantly invest in research. They also mentioned that *Takaful* companies need to be innovative; focusing on human, green environment and sustainability; and that a good business model would reduce the agency cost and the overall costs. For good quality of operation, features of *Takaful* products must be explained in detail to consumers to ensure they properly understood the contract before committing themselves to the policy. Other relevant requirements to enhance operations, as recommended by IFSB-9, include a mandated ‘cooling-off’ period within which the policyholder may terminate the contract, enabling the purchase decision to be revisited. The six experts caution that products for trade credit *Takaful* is inadequate compared to the number of products available for trade financing. They also opine that the marketing strategy for the present channel distribution is similar to that of the conventional insurance where *Takaful* companies rely largely on intermediaries, mostly banks to sell their products. Meanwhile one expert from Turkey views that in addition to the customers' demands and needs, the constant change in technology and competition requires the *Takaful* companies to develop new products in order to survive in the market and increase their competitiveness.

Two experts from Saudi Arabia said that SAMA is encouraging the Insurance Industry to come up with innovative products to help grow the industry in the kingdom. They also mentioned that the majority of the market share in Saudi Arabia is dominated by compulsory products (Medical & Motor insurance), although there is a commitment for growing other lines of businesses especially the Life insurance. The experts warn that the size of *Takaful* companies is small, which does not allow them to grow and compete on equal footing with their conventional counterparts. They therefore suggest that regulators should not approve small companies, which are unlikely to do well in the market.

4. *How does Shari'ah framework play a crucial role in the Takaful?*

The experts are unanimous that the *Shari'ah* framework is the backbone of the *Takaful* industry. Four experts from Malaysia affirm that any *Takaful* operator in Malaysia that does not comply with the *Shari'ah* would receive severe punishment from the authority to the extent of revoking its license and closing down the company. Such measures instil confidence in the customers and give them assurances. The four experts advise *Takaful* companies to have *Shari'ah* secretariat to manage the *Shari'ah* committee. The secretariat performs three key functions: *Shari'ah*, office management and compliance, and R & D. Furthermore, the four experts stated the *Shari'ah* governance system provided by IFSB standards have two different perspectives: the IFSB-8, which is focused on the *Takaful* sector, and IFSB-10 that discusses *Shari'ah* governance system holistically. IFSB-10 ensures issuance of relevant *Shari'ah* pronouncements /resolutions; dissemination of information on such *Shari'ah* pronouncements / resolutions; an internal *Shari'ah* compliance review / audit, and an annual external *Shari'ah* compliance review. Meanwhile IFSB-8 provides best practices on approaches to reinforce good governance. One of the experts from Turkey considers *Shari'ah* framework necessary for providing check and balance to the operations and product of the *Takaful* industry to ensure they comply with the *Shari'ah*. According to him, such framework also provides disclosure and transparency and gives confidence to customers. An expert from Saudi Arabia states that in the Kingdom the cooperative law is applicable to all insurance business. He also affirms that the general *Shari'ah* framework agreed upon such as AAOIFI *Shari'ah* standards should not be questioned, especially when such standards are already being practised by several countries.

5. ***What are the measures that should be taken to improve the infrastructure in the Takaful industry?***

Over sixty per cent of the twelve experts interviewed agree that there is room for improving the infrastructure of the *Takaful* industry. Two experts from Malaysia suggest that one way would be for the government to encourage external foreign partners to establish local *Takaful* to allow technology transfer and for the locals to learn from foreign expertise. The two experts explained that a well-developed financial sector infrastructure should comprise elements such as efficiency and independent judiciary; comprehensive and well-defined accounting principles and rules that command wide international acceptance; well-defined governance rules, and adequate supervision. They also commented that laws governing the *Takaful* sector including insolvency, contract and consumer protection must be developed and adequately enforced to provide a mechanism for fair resolution of disputes. Once these laws are well-develop, *Takaful* operators would be able to uphold their fiduciary duties and responsibilities to the highest level. According to the three experts from Turkey, technological infrastructure has become an indispensable part of everyday life and thus *Takaful* companies should invest in related software to upscale their delivery. Furthermore, the Turkish experts stated that legislation should be developed, product diversification should be made and the theoretical structure of the system should be enhanced. The calculation techniques, methods and programs that companies apply to generate premium production and make investment and, follow up compensation and payment processes should also be updated in accordance with the conditions of the day and principles of *Takaful*. One expert from Saudi Arabia suggests that the most important infrastructure of *Takaful* is *Re-Takaful*, which is still an infant industry in many jurisdictions. There should hence be legislative arrangements to enhance *Re-Takaful.*

6. ***What should be done at the Market level to strengthen the competitiveness of the Takaful Industry against its conventional counterpart?***

All the experts agree that there is a need for strengthening the competitiveness of the *Takaful* industry. Four experts from Malaysia are of the opinion that *Takaful* operators need to be innovative and design their own products that are unique to the conventional ones. The products should be simple to customers and easy to understand. Today customers are sophisticated, well equipped and knowledgeable. The Malaysian experts explained that the growth of *Takaful* in the country was faster than its conventional counterpart. Nevertheless, they acknowledge that there is a need for educating the public about the *Takaful* market, which should begin at the school level, the college right up to the university. This view is also shared by two experts each from Turkey and Saudi Arabia that there should be an emphasis on education in addition to training to strengthen the competitiveness of the industry. The four experts from Malaysia cautioned that the industry needs to go beyond the *Shari'ah* compliance strategy if it were to enhance its competitiveness and the traditional *Takaful* markets need to update and improve their intermediaries and inter-professional bodies through fees, education and training. Intermediaries have direct contacts with customers.

One expert from Turkey has acknowledged that conventional insurance is a market leader in the country. Yet more than 80% of the insured values in Turkey are not yet insured. This provides an opportunity for the *Takaful* industry to develop a strategy to penetrate the market rather than thinking of becoming a market leader. In addition, the *Takaful* industry can develop products to meet the needs of customers who are not interested in the conventional insurance product. Two experts from Saudi Arabia say that the cooperative law is applicable to all insurance business in the Kingdom and accordingly there is hardly any competition between the *Takaful* and conventional insurance markets. The two Saudi experts added that enhancing the competitiveness of the *Takaful* industry would require the industry to avail more *Re-Takaful* providers and more *Shari'ah* compliant investment products and services.

7. *What should be done to enhance the Human capital level of the Takaful Industry?*

The experts in the three countries agree that enhancing the quality of the human resource is vital to the *Takaful* industry. Five experts from Malaysia commented on the human resource challenges facing the *Takaful* industry. They said the industry has antiquated conventionally trained human capital, recruited from the conventional insurance industry when *Takaful* had just started. The five experts also commented that most professionals, brokers and agents who sell *Takaful* products lack basic *Shari'ah* knowledge. They added that most of those working in the *Takaful* sector are largely specialized in banking, finance, accounting and the capital market sectors. Few are specialized in *Takaful*. Even in academia, it is difficult to find lecturers with *Takaful* knowledge and experience. This situation is evident of the dire need for expertise in *Takaful*. The five Malaysian experts suggest that there is a need for strengthening the relationship between academia and industry experts. With such arrangements, the academia can develop relevant curriculum and produce students with the required skills. On the other hand, the industry expert can also teach in learning institutions and conduct training. There will also be rooms for joint research. Furthermore, they suggest that there must be a minimum standard that all *Takaful* professionals must have, such as a certificate. Such qualification instils certain values, integrity and professionalism to project the *Takaful* industry and earn for it respect from similar industries. All these measures will help enhance the quality of human resource in the *Takaful* industry.

An expert from Turkey suggests that in order to enhance the quality of human resource and maintain their values through the human resource ecosystem, *Takaful* companies need to address all their employees to understand and relate to the meaning of the work. Managers should adopt supportive, clear and transparent administrations with realistic goals; working environment should be humane, flexible and; *Takaful* companies should provide education, development opportunities in addition to academic studies and training programs for technical skills related to insurance, *Takaful* and Fiqh. Three experts from Saudi Arabia commented that the insurance industry in the Kingdom is relatively young and significant investment is required for human capital development especially in training. The three experts share the sentiment that human capital development is good for the industry and training centres and licensing of professionals are commonly available. They said emphasis should be given to *Takaful* education in universities and institutes.

8. *How effective are the regulations and market practices on consumer protection, and the mechanism of dispute resolution in the Takaful Industry?*

The experts have expressed different experiences that varied with the jurisdictions in the three countries they represent. Generally, however, they share the views that there is room for improvement in terms of developing specific laws for the protection of *Takaful* consumers and enhancing the awareness of *Takaful* consumers about their rights and responsibilities. Five out of the six experts from Malaysia concur that regulations in Malaysia broadly provide protections for consumers and there is no specific provision for the *Takaful* consumers. However, the Islamic Financial Service Act [IFSA 2013] provides a framework for the protection of *Takaful* consumers especially at the solvency of *Takaful*. Thus the infrastructure is already in place pending specific laws. Meanwhile *Takaful* operators have complaint unit and online channels in place operating 24 hours to receive customers' complains. This unit is also monitored by Bank Negara, the central bank of Malaysia. IFSA 2013 also has provisions for dispute resolutions for the Islamic banking and *Takaful* industries.

Two of the three experts in Turkey relate that in 2007, the Insurance Law No. 5684 was adopted to ensure the development of insurance in our country, to protect the rights and interests of the persons involved in the insurance contract, and to ensure that the insurance sector operates effectively in a safe and stable environment. In the meantime, Article 30 of the same law provides for an insurance arbitration system for the settlement of disputes arising from the insurance contract. Since 2007, the insurance Arbitration Commission has been conducting proceedings and making decisions on disputes arising out of the insurance contract, including insurance contracts in which one of its parties is a consumer within the framework of the procedures and principles laid down by the legislation. The two experts cautioned the low level of awareness among the consumers about their rights and responsibilities regarding insurance, and there is a dire need for remedying the situation.

Meanwhile two experts from Saudi Arabia share the view that at SAMA there is a strong focus on consumer protection with various legislations supporting the same. The introduction of Risk-Based Supervision (RBS) in 2010 provides additional focus on consumer protection. There is also an insurance dispute resolution committee in Saudi Arabia that is independent of SAMA. Furthermore, the insurance contract is supposed to be fair in terms of rights and liabilities and provides protection for both contracting parties [company and policyholder]. Moreover, the contracts have to get the approval of the regulator and they are not left to the discretion of insurance companies. On the other hand, dispute resolutions are handled by specialized courts at all levels.

9. ***How can FinTech be used to strengthen the Takaful Industry and what are the measures that should be undertaken?***

The experts from the three countries are unanimous that the benefits of Fintech to the *Takaful* industry outweigh its cost. The five experts from Malaysia explain that technological developments and the changing expectations of customers are the main drivers of innovation in the global financial services industry including *Takaful*. They say FinTech innovations have the potential to deliver a wide range of benefits – in particular, efficiency improvements, cost reductions, improved risk assessment, superior customer experience and greater financial inclusion. They further elaborated that FinTech will make the *Takaful* companies competitive due to cost efficiency and product innovation. *Takaful* will become cheaper and more accessible. For example, customers can make use of smart contracts for *Takaful* products, avoiding the hassles of filling in forms and paper works. The FinTech platform will reduce the need for *Takaful* agents and distributors and save the commission. They also caution that some of these innovations could also have negative implications for consumers and the financial stability of *Takaful* markets.

According to the five experts from Malaysia, the most relevant emerging technologies for the *Takaful* industry are digital platforms, the Internet of Things, telematics, big data, data analytics, comparators, robo-advisors, machine learning, artificial intelligence and distributed ledger technology, including Block-chain and smart contracts using various Business models like peer-to-peer, usage-based and on-demand. They said these innovations are being developed both by incumbent *Takaful* companies and by new technology firms or new companies known as “InsurTech” start-ups. The five experts acknowledge that FinTech developments are potentially disruptive and may have a significant impact on the *Takaful* market. The experts conclude that FinTech provides an opportunity to engage consumers and to offer efficient services.

Three experts from Turkey share the view that the insurance industry is conservative compared to other FinTech industries in terms of Internet of Things, cloud, artificial intelligence, smart contracts, reliable use of personal data, image processing technologies, and the insuring of the digital world. However, innovation, efficiency, growth, quality, and competitiveness are the opportunities that can take companies one step forward. They explain that we are in a period where FinTech is beginning to influence a vast ecosystem, even economic policies itself. In this context, it is also important how the different stakeholders in the ecosystem behave in terms of competition or cooperation. While the technological transformation has made it easier for people to access financial services, the products and services provided increase both the diversity and quality of the products and reduce the costs. Although innovative ideas have reached the dimensions that are sometimes considered destructive in the financial services sector, this transformation will continue to be an important part of our social and economic life.

They further elaborated that as in all fields, the use of FinTech in *Takaful* has become a necessity. Insurance will become impossible unless the FinTech is utilized, and new developments are embraced. FinTech can be used to explain the difference and essence of *Takaful* and make it more accessible to consumers. In the FinTech ecosystem, people can see clearly and recognize the major differences between *Takaful* and conventional insurance.

Two experts from Saudi Arabia commented that information technology is playing a vital role in all industries and *Takaful* is no exception. They say the insurance industry in Saudi Arabia is relatively young and significant investment is required for it to grow in all aspects. There is presently increasing awareness in the market for companies to invest in new technologies, including FinTech, for them to protect their positions, expand market share and have competitive edge.

10. *How do you foresee the future of the Takaful industry?*

Over 80% of the experts interviewed are optimistic about the future of the *Takaful* industry. They see a continuous growth and expansion. Nevertheless, they are cautious about the pace of the growth and several aspects that need to be enhanced such as leadership, quality of the human resource, innovative original products, investment in technology and competitiveness.

Three experts from Malaysia explain that the global *Takaful* industry has witnessed a remarkable double-digit growth in the last decade, for instance, recording 19% growth between 2009 and 2010. Nevertheless, *Takaful* has not grown at levels to keep pace with the growth in Islamic banking and finance. *Takaful* is severely underpenetrated, especially in Family *Takaful* segments. The experts commented that the *Takaful* industry success lies in fixing a range of the following areas: revisiting the objectives of its establishment; the ethical impact of *Takaful* product must be understood and visibly seen to positively impact the daily lives of people, business and investors and; the value proposition of *Takaful* needs to be more apparent and distinct from the conventional insurance. The three Malaysian experts suggest the following priorities for the industry to embark on to realise the full potential of *Takaful*:

a. the presence of players with deep *Shari'ah* knowledge within our domestic *Takaful* and *Re-Takaful* companies, and an entire Islamic finance ecosystem that can be tapped into to really push the frontiers.

b. the *Takaful* industry needs to conduct itself in a way that alleviates, not add, to the hardship of customers. The principle of *kafalah* emphasising mutual help and assistance, *Takaful* must do more. This underscores the importance of *Takaful* operators to be accessible, empathetic, fast and reliable. Not just when selling, but also when providing after-sales service and processing claims.

c. The *Takaful* industry needs to be innovative and develop its own products rather continuing mimicking conventional products. Furthermore, the industry should move beyond retail consumer and should look at trade and entrepreneur customers with diversification to another value chain in the production, not just focusing on credit.

Finally, they added, for the *Takaful* industry to offer its potential that is yet untapped, the industry has to have the right people with the right competence. Strong leadership and quality talent are needed to steer the industry forward to reach greater heights.

Three experts from Turkey commented that the participation insurance premium production in Turkey grew 6 times over the last 5 years reaching TRY 2.2 billion at the end of 2018. In the same period, it increased its market share from 1.48% to 4%. Although these developments are not sufficient, the experts elaborated, they are promising for the future of the *Takaful* industry. The experts are optimistic that this rate of growth will increase further with the development of legal regulations, attractive incentives, education, and infrastructure. The experts cautioned that *Takaful* practice started with good ethical and *Shari'ah* based principles and sincere purposes, but in practice it has been converging with the conventional insurance. Such a trend if left unchecked can erode public confidence in the long run in *Takaful* products. The three experts suggest that countries and institutions applying *Takaful* should trust in the system in every aspect and make the necessary legal, technical and technological investments for the system to grow and develop on a solid foundation and they should train enough human resources.

The three experts from Saudi Arabia are also optimistic that the future of the *Takaful* industry is bright and promising. They believe that it is growing and will expand its market share and double its growth in the near future. They say *Takaful* is the reflection of solidarity in a society and that its impact including the impact of *Re-Takaful* on the economies of Muslim countries is huge if managed. The experts explained that the 'Financial Sector Development Program (FSDP)' initiated by the Kingdom is one of the delivery programs towards the realization of Saudi Vision 2030. FSDP includes various KPI's which will spur the growth of the insurance industry in Saudi Arabia. The three experts also cautioned that they see little progress if regulators do not give the *Takaful* industry what it deserves to sustain its growth.

CHAPTER 7: POLICY RECOMMENDATIONS

This chapter provides policy recommendations on *Takaful* industries in the four countries, namely the UK, Turkey, Malaysia and Saudi Arabia, selected for this study. Twenty policy recommendations are proposed based on the data obtained from the review of extant literature, country case studies, content analysis of published documents and questionnaire survey administered to *Takaful* industry players, regulators, *Shari'ah* scholars and academicians; and the data were also sourced from interviews conducted with 12 experts. These recommendations are presented for the following five areas: 1) legal and regulatory framework, 2) *Shari'ah*, 3) product and services, 4) talent development, and 5) *Takaful* business sustainability.

8.1. Legal and Regulatory Framework

The enactment of new regulations in many countries provides clear recognition to the Islamic financial system and greater clarity on the regulatory and legislative framework for Islamic finance, which includes recognizing the specificities of *Takaful* in last few years. However, regulations for the *Takaful* industry are at the very beginning of a long way to go. It can be said that regulatory framework for the *Takaful* industry is quite limited compared to the other finance and Islamic finance fields. Comprehensive regulations and government support are highly demanded by the *Takaful* industry mostly for operating, transparency, and governance issues which can increase viability and the competitiveness of the sector. Regulatory and governance are almost always on the agenda and the need is increasing (COMCEC, 2016).

TABLE 22: LEGAL AND REGULATORY FRAMEWORK ISSUES AND POLICY RECOMMENDATIONS

No	Issues	Policy Recommendation	Country Affected
1	**1.1. Absence of a comprehensive *Takaful* legal and regulatory framework**	Developing the *Takaful* Act	UK, Turkey and Saudi Arabia
		Developing specific *Takaful* laws	Malaysia
		Standardization of financial accounting and reporting, and tax laws related to *Takaful*	Applies to all the four countries

Source: Authors

Through regulations, the institutionalization of the *Shari'ah* committees both in country level and TO level as the apex authority or main management function serves to provide legal and contractual certainty for Islamic finance transactions. Some of the *Takaful* operating countries have *Shari'ah* governance framework even needs further regulatory actions and improvements. However, there is a need in many untapped economies for it. Furthermore, there is a need for enhancing the proficiency of committee members through training programs.

Through international standards, TOs are guided in their application of the *Shari'ah* concepts in product development and innovation. Furthermore, the regulatory requirements such as capital, risk governance, and transparency and disclosure are in place to ensure stability and sustainability of the financial institutions including TOs. In addition, there are also prudential standards and requirements which specifically cater to distinct features of Islamic finance. These standards strengthen the governance of TOs, provide greater clarity on the use of multiple *Shari'ah* contracts in the models and structures of *Takaful*, and safeguard the interests of *Takaful* participants.

In general, the *Takaful* industry lacks a comprehensive legal and regulatory framework. The major challenges include lack of *Takaful* Act, specific laws and standardization of financial accounting and reporting, and tax laws related to *Takaful*. For example, in Turkey there is no specific *Takaful* act. The banking sector in the country is mainly regulated by BRSA and CMB. In contrast, Malaysia has *Takaful* regulatory framework in place pending specific laws.

8.2. *Shari'ah* Framework

All the activities of *Takaful* must be guided by the *Shari'ah*. Apparently, there is a variation to the degree of *Shari'ah* framework for *Takaful* in the four countries selected for this study: Saudi Arabia, Malaysia, Turkey and UK. Among all the four countries, Malaysia has made tremendous progress in terms of *Shari'ah* framework for *Takaful*. Its Islamic Financial Service Act (IFSA, 2013) provides a comprehensive *Shari'ah* framework that recognizes the specificities of *Takaful*.

TABLE 23: *SHARI'AH* ISSUES AND POLICY RECOMMENDATIONS

No	Issues	Policy Recommendation	Country Affected
2	**2.1. Absence of a comprehensive *Shari'ah* governance framework for *Takaful***	Developing a *Shari'ah* governance framework for *Takaful*	UK, Turkey and Saudi Arabia
	2.2. Lack of *Takaful Shari'ah* standards	Developing *Takaful Shari'ah* standards	UK, Turkey and Saudi Arabia
	2.3. Conflict between the existing legal framework and *Shari'ah* requirements	Harmonizing the existing legal framework with *Shari'ah* requirements	Applies to all the four countries
	2.4. Absence of *Shari'ah* conflict resolutions	Establishing *Shari'ah* units for conflict resolutions and empowering *Shari'ah* committees	UK, Turkey and Saudi Arabia

Source: Authors

The *Shari'ah* Advisory Council (SAC) as part of the *Shari'ah* governance framework is the apex authority that guides the *Takaful* industry on *Shari'ah* related issues. IFSA has also paved the way for the development of various *Shari'ah* standards to guide TOs. These standards strengthen the governance of TOs, provide greater clarity on the use of multiple *Shari'ah* contracts in the models and structures of *Takaful*, and safeguard the interests of *Takaful* participants. In the other three jurisdictions, Turkey, Saudi Arabia and the UK, there is the absence of Islamic finance and *Takaful* act and lack of central *Shari'ah* board. The insurance industry in these three countries is largely governed by conventional laws. *Shari'ah* framework and matters are left to the discretion of individual insurance and Islamic finance institutions. It would take some time for these countries to institute comprehensive *Shari'ah* framework for *Takaful*.

Some of the major challenges facing the *Takaful* industry especially in the three out of the four countries selected for this study are: the absence of a comprehensive *Shari'ah* governance framework for *Takaful*, lack of *Takaful Shari'ah* standards, conflict between the existing legal framework and *Shari'ah* requirements, and absence of *Shari'ah* conflict resolutions. For example, there exist numerous conflicts between the *Shari'ah* principles and domestic laws. There are cases involving Islamic contracts claimed to be non-*Shari'ah* compliant due to ambiguous clauses.

8.3. Products and Services

Product development, innovation, new business models and quality of operations play positive roles in the growth of the *Takaful* industry. *Takaful* companies must continue to invest in research and product development. They need to be innovative and strategize for sustainability.

TABLE 24: PRODUCT AND SERVICES ISSUES AND POLICY RECOMMENDATIONS

No	Issues	Policy Recommendation	Country Affected
3	**3.1. Lack of innovation and use of technology**	Developing unique and original products	UK, Turkey and Saudi Arabia
		Investing in technology	UK, Turkey and Saudi Arabia
	3.2. Lack of customer awareness	Awareness campaign among the public and in schools and colleges	Applies to all the four countries
	3.3. Weak market penetration and distribution channels	Promote the use of technology particularly InsurTech, and mobile apps for micro-*Takaful*	UK, Turkey and Saudi Arabia
		Diversify products to include trade insurance	Applies to all the four countries
		Offer more *Re-Takaful* businesses	Applies to all the four countries

Source: Authors

A good business model and product must be competitive, cost-effective and appealing to consumers. *Takaful* companies must not continue to mimic the marketing strategy being adopted by the conventional insurance. Instead they must innovate original products and services. The constant change in customers' taste and demands requires *Takaful* companies to continue developing new products in order to survive in the market and increase their competitiveness.

With the adoption of big data analytics, artificial intelligence and online channels, TOs will be able to anticipate risks and demands with far greater precision. This allows for greater product customization by TOs to suit the rapidly changing needs of the market and improve participant experience when consuming financial services. For example, wearable computing that collects real-time data makes underwriting process and managing on-going health claims more collaborative and more convenient for participants. Participants' behaviour and healthy lifestyle that are monitored and compensated through discounts in their plan also makes the product much more versatile and appealing in the eyes of participants. Participant experience can also be enhanced with value-added services, as technology enables new business models through new and improved forms of distribution. For example, TOs can develop mobile/tablet financial planning apps which help illustrate *Takaful* more clearly and vividly to customers. This enables customers to understand the product features better and make informed-decision when choosing a *Takaful* product. The risk of misconduct by agents could also be reduced, since important part of insurance companies and TOs complain about force selling, mis-selling or misrepresentation.

Diversity in products and services, powered by technology adoption, has significant potential to position the *Takaful* industry with a competitive edge to serve consumers better. Besides new coming TOs can use InsurTech investments and technology-based products and services as an entry-strategy to the market. It should be noted that the new entries expand the market. There is also a demand for increase in non-banking IFIs for developing the role of Islamic finance in the overall economy (COMCEC, 2019). While focusing on product on ongoing operations based technology adaptation the main *Takaful* software for TOs still needs to be developed to strengthen operation quality and improve participant experience.

8.4. Talent Development

Human capital strategies should focus on investments to attract and develop highly skilled talent, as the reality is good talent is in short supply. First, competitive remuneration is important. Second, it is a must to continuously up-skill and build competencies of employees across all levels. TOs must set a clear vision and culture of continuous learning and development. In particular, the Takaful workforce should be equipped with an understanding of Islamic finance and Takaful specificities. Programs for professional certification can help increase specialization of employees with exposure to in-depth knowledge on Islamic finance including Takaful. There is a need for developing certain training programs and academic publications as well as periodical reports and other materials. Employees should also be encouraged to acquire and develop their technical knowledge and competencies applicable in respect of risk management, underwriting and regulatory requirements.

Table 25: Talent Development Issues and Policy Recommendations

No	Issues	Policy Recommendation	Country Affected
4	**4.1. Lack of *Shari'ah* knowledge**	Develop certificate and in-house training programs for the relevant *Takaful* stakeholders [executives, managers, agents and brokers]	Applies to all the four countries
	4.2. Lack of conventional insurance knowledge	Develop certificate and in-house training programs for *Takaful* executives, managers and *Shari'ah* board members	Applies to all the four countries
	4.3. Lack of adequate skills in emerging technology and product development	Develop certificate and in-house training programs for *Takaful* executives and managers	Malaysia, Turkey and Saudi Arabia
		Enhancing collaboration between the *Takaful* industry and the academia	Applies to all the four countries
		Technical assistance from relevant International Islamic organizations	Applies to all the four countries

Source: Authors

The need to build competencies on *Takaful* is also applicable to agents as they are also an important component of the *Takaful* ecosystem. Third, greater collaboration with brokers and bank partners is also imperative in supporting business growth, outreach and diversification. To support the development of the *Takaful* industry, it is also important to have a strong and dynamic industry association that is able to drive the strategic development of the industry, establish best practices to which the industry players adhere to and represent the industry in raising relevant industry issues and opportunities for deliberation with various stakeholders.

8.5. *Takaful* Business Sustainability

Takaful penetration in OIC countries remains low at a small percentage of the entire population. Nevertheless, the growth opportunity for the *Takaful* industry remains promising, provided OIC countries truly understand the value of protection to achieve household resilience and sustainable economic growth. The *Takaful* industry will also continue to operate in a much more competitive and challenging environment with rapidly evolving business and economic landscape, including facing the effects of climate change.

TABLE 26: TAKAFUL BUSINESS SUSTAINABILITY ISSUES AND POLICY RECOMMENDATIONS

No	Issues	Policy Recommendation	Country Affected
5	**5.1. Low growth and lack of competitiveness**	Create mega *Takaful* business through merger and acquisition	Applies to all the four countries
		Create favourable tax incentives	Applies to all the four countries

Source: Authors

It is imperative for the industry to continue designing and delivering solutions that meet the real needs of the economy and offer positive experience to participants to stay relevant. To achieve this, TOs must strive to address protection gaps in OIC countries, rather than merely replicating available insurance offerings. Unique features of *Takaful* would strengthen the value proposition and business sustainability of the industry.

The following table summarises the policy recommendations and identifies the list of agencies responsible for the implementation:

TABLE 27: POLICY RECOMMENDATIONS AND THE IMPLEMENTING AGENCIES

No	Item	Policy recommendations	Implementing agencies
1	**Legal and Regulatory Framework**	Developing the *Takaful* Act	• Saudi Arabia: SAMA • UK: Financial Conduct Authority (FCA), complemented by the Islamic Insurance Association of London (IIAL) • Turkey: BRSA and CMB
		Developing specific *Takaful* laws	• Malaysia: BNM
		Developing *Takaful* standards	• Saudi Arabia: SAMA • UK: Financial Conduct Authority (FCA), complemented by the Islamic Insurance Association of London (IIAL) • Turkey: BRSA and CMB
2	***Shari'ah* Framework**	Developing the *Shari'ah* governance framework for *Takaful*	• Saudi Arabia: SAMA • UK: Financial Conduct Authority (FCA), complemented by the

No	Item	Policy recommendations	Implementing agencies
			Islamic Insurance Association of London (IIAL) • Turkey: BRSA and CMB
		Developing *Shari'ah* standards for *Takaful*	• Saudi Arabia: SAMA • UK: Financial Conduct Authority (FCA), complemented by the Islamic Insurance Association of London (IIAL) • Turkey: BRSA and CMB
		Harmonizing the existing legal framework with *Shari'ah* requirements	• Saudi Arabia: SAMA • UK: Financial Conduct Authority (FCA), complemented by the Islamic Insurance Association of London (IIAL) • Turkey: BRSA and CMB • Malaysia: BNM
		Establishing *Shari'ah* units for conflict resolutions and empowering *Shari'ah* committees	• Saudi Arabia: SAMA • UK: Financial Conduct Authority (FCA), complemented by the Islamic Insurance Association of London (IIAL) • Turkey: BRSA and CMB
3	**Product and Services**	Developing unique and original products	• TOs in the four countries
		Investing in technology	
		Awareness campaign among the public and in schools and colleges	
		Promote the use of technology particularly InsurTech, and mobile apps for micro-*Takaful*	
		Diversify products to include trade insurance	• TOs in the four countries
		Offer more *Re-Takaful*	• TOs in the four countries

No	Item	Policy recommendations	Implementing agencies
		businesses	
4	**Talent Development**	Develop certificate and in-house training programs for the relevant *Takaful* stakeholders [executives, managers, agents and brokers]	• Saudi Arabia: SAMA • UK: Financial Conduct Authority (FCA), complemented by the Islamic Insurance Association of London (IIAL) • Turkey: BRSA and CMB • Malaysia: BNM • TOs in the four countries
		Develop certificate and in-house training programs for *Takaful* executives, managers and *Shari'ah* board members	• Saudi Arabia: SAMA • UK: Financial Conduct Authority (FCA), complemented by the Islamic Insurance Association of London (IIAL) • Turkey: BRSA and CMB • Malaysia: BNM • TOs in the four countries
		Develop certificate and in-house training programs for *Takaful* executives and managers	• TOs in the four countries
		Enhancing collaboration between the *Takaful* industry and the academia	• TOs and institutions of higher learning in the four countries
		Technical assistance from relevant International Islamic organizations	• Islamic Development Bank [IDB] • Organization of Islamic Conference [OIC] • Islamic Financial Service Board [IFSB]
5	**Low growth and lack of competitiveness**	Create mega *Takaful* Business through merger and acquisition	• TOs in the four countries
		Create favourable tax incentives	• TOs in the four countries

Source: Authors

CHAPTER 8: CONCLUSION

Takaful, the Islamic *Shari'ah* compliant insurance, has been in practice in many OIC and non-OIC member countries for the last thirty-eight years. The industry is growing slowly but steadily and is expected to spread to several other Islamic and non-Islamic countries in the near future. Although *Takaful* is well developed in some countries, like Malaysia and Saudi Arabia, there are still more rooms for promoting, encouraging and developing it, so that it is well understood and is reachable to a number of Muslim clientele who need *Takaful* but have no access to it.

The main objective of this research project, commissioned by COMCEC, is to conduct a landscape study of the existing *Takaful* industry in OIC and non-OIC countries, assess its development, analyse the related issues and suggest policy recommendations for further enhancing the growth of the industry in OIC member countries and worldwide.

The study has adopted several research methods to achieve the objectives of the project. Firstly, the survey went through extant literature for the landscape survey, state of the art of the *Takaful* industry for identifying the issues and the research gaps. Secondly, the write-up of the project, required content analysis of reports and publications on *Takaful*. Thirdly, the survey of country cases was undertaken in order to assess the strength and weaknesses of the *Takaful* industry for each of the four countries (Malaysia, Saudi Arabia, Turkey, and the UK), which were selected for the study. Finally, a mixed method comprising survey questionnaire and expert interviews were conducted with relevant stakeholders to solicit data on the challenges. SWOT analysis was also used to determine the future direction of the *Takaful* industry at the local, regional and global levels.

The major findings of the study are mixed. For instance, the landscape survey shows that the *Takaful* industry is growing steadily, and the prospect is promising. However, the growth is increasing at a slow pace. This is, perhaps, due to several challenges, such as the lack of regulatory and legal frameworks, the need of human capital development, the weak information technology, the inappropriate infrastructure, the weak *Shari'ah* governance, the less diversified products and services, and the non-standardized business operations.

The results from the country case studies show wide variations in the levels of development of the *Takaful* industry. Malaysia has made great achievements by putting in place the *Takaful* regulatory and legal framework, *Shari'ah* governance and efficient business operations. On the other hand, the other three countries need time to enact *Takaful* laws and develop their *Shari'ah* governance structure. The UK, Malaysia, Turkey and Saudi Arabia need to invest in technology and human resource to enhance their products and services and their delivery channels. All four countries are in need of educating the public about the benefits of *Takaful* through awareness campaigns.

In view of the slow growth of the *Takaful* industry and the challenges in some key areas, this report provides some policy recommendations to further develop the industry and expand its outreach.

The policy recommendations identified are classified into five broad areas:

- Firstly, enhancing the legal and regulatory framework by developing specific *Takaful* laws in the case of Malaysia and creating new Acts in the cases of the UK, Turkey and Saudi Arabia.
- Secondly, the report recommends the harmonization of existing local laws with *Shari'ah* requirements, creating *Shari'ah* units for dispute resolutions and empowering the *Shari'ah* committee, developing the *Shari'ah* governance framework and *Shari'ah* standards to guide TOs.
- Thirdly, for products and services, it is recommended that *Takaful* companies innovate unique and original products, invest in technology particularly, InsurTech, and mobile apps for micro-*Takaful*, diversify products to include trade *Takaful* and more *Re-Takaful* businesses and increase public awareness campaign.
- Fourthly, for talent development, the study recommends in-house training and certificate programs, technical assistance and collaborations between the industry and the academia.
- Finally, the report provides two policy recommendations to be used to spur growth in the *Takaful* industry: the creation of mega *Takaful* companies and favourable tax incentives.

So, the recommendations could be generalised to the other Islamic countries based on the level of Takaful sector development as follows:

I. For New and Emerging *Takaful* markets:

- ***Set up the supportive regulatory and legal frameworks*** creating the level-playing ground with adjusting the taxation, requiring more transparency and disclosure, and softening the capital requirements and solvency margins.
- ***Increase the awareness of the market about the nature of Takaful*** to attract the new customers and increase the market confidence.
- ***Develop the Shari'ah framework*** with clear standards and governance.
- ***Develop a comprehensive Islamic finance infrastructure*** making available the *Shari'ah*-compliant instruments for investment, creating a well-developed distribution network, and introducing the *Re-Takaful* services.
- ***Build a human capacity*** by offering the education programmes and attracting talents.

II. For Developed *Takaful* markets:

- ***Embrace new technology and maintain cybersecurity*** to sustain the quality of operations and products and penetrate the new markets.
- ***Ensure the continuous human capital development*** to increase the quality of services and achieve the higher level of customer satisfaction.
- ***Stimulate innovation*** including new business models and product development.

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APPENDIX

TABLE 28: ISLAMIC FINANCE DEVELOPMENT INDICATORS - 2018

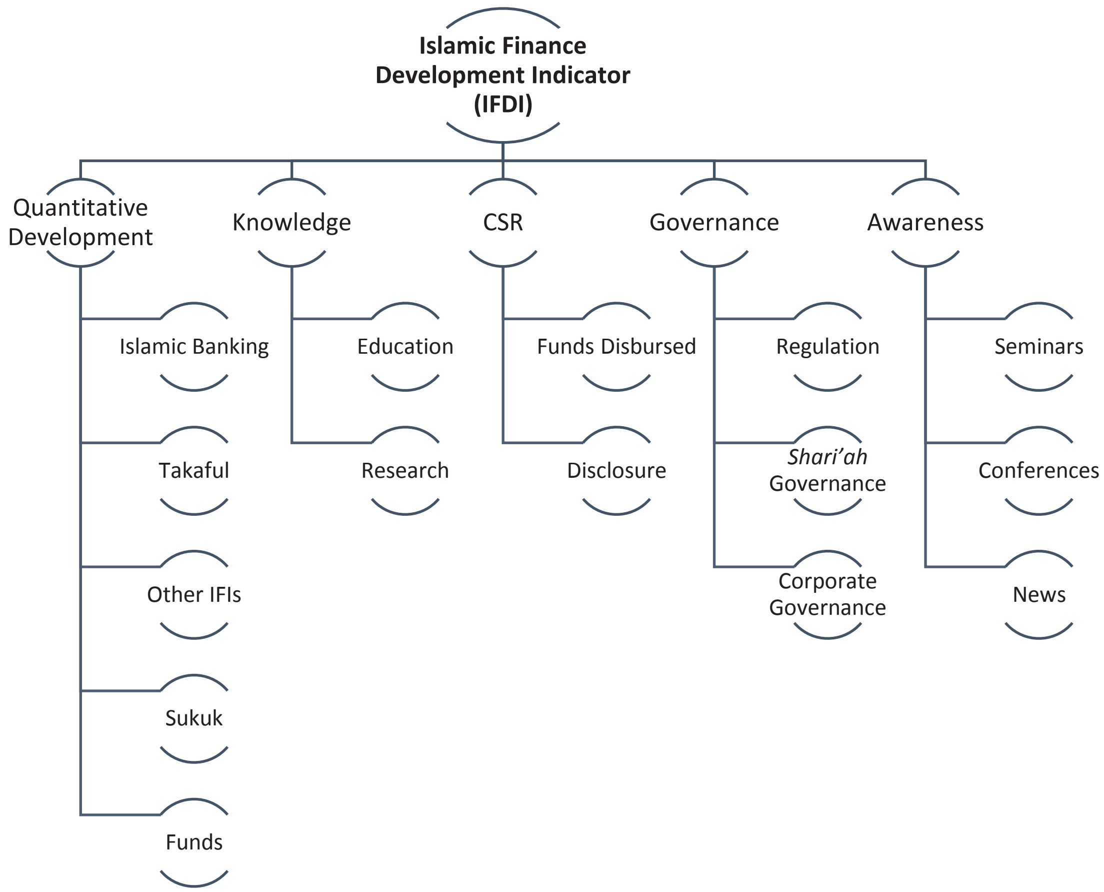
INDICATORS (2018)	MY	SA	TR	UK
Islamic Finance Development Indicator (IFDI)	131.86	56.08	21.32	14.68
QUANTITATIVE DEVELOPMENT	**98.50**	**56.80**	**12.28**	**4.30**
Islamic Banking	**66.70**	**58.05**	**18.96**	**2.08**
Islamic Banking Assets (US$ Million)	201,392	375,884	41,379	5,232
Number of Islamic Banks	22	5	5	7
Number of Islamic Banking Windows	16	11		8
Number of Listed Islamic Banks	1	4	1	2
Islamic Banking Return on Assets	0.78%	0.76%	1.07%	
Takaful	**41.63**	**92.92**	**21.71**	**0.21**
Takaful / *Re-Takaful* Assets (US$ Million)	9,088	15,217	704	
Number of *Takaful* / *Re-Takaful* Operators	20	35	9	2
Number of Listed *Takaful* / *Re-Takaful* Operators	1	33		
Takaful Operators Return on Assets		2.50%	3.54%	
Other IFIs	**102.93**	**38.27**	**1.54**	**0.69**
Other Financial Institutions Assets (US$ Million)	49,666	13,152		
Number of Other Financial Institutions	22	68		11
Number of Listed Other Financial Institutions	4		5	
Return on Assets for Other Financial Institutions	6.30%			
Sukuk	**182.29**	**42.82**	**15.08**	**5.08**
Number of Sukuk Issued	530	20	58	
Number of Outstanding Sukuk	1945	86	58	5
Value of Sukuk issued (US$ Million)	34,673	26,044	3,421	
Value of Outstanding Sukuk (US$ Million)	203,500	80,938	12,106	1,396
Number of Listed Sukuk	35	41	58	4
Bid / Ask spread	0.48	0.39		0.38
Funds	**98.96**	**51.93**	**4.11**	**13.45**
Number of Islamic Funds	300	207	6	64
Net Asset Value of Islamic Funds (US$ Million)	27,260	24,115	31	867
Number of Islamic Funds launched	41	10		7
Number of Islamic Asset Managers	41	41	4	7
Cumulative Performance	2023%	72%	378%	1635 %
KNOWLEDGE	**228.37**	**42.89**	**15.32**	**15.48**
Education	**156.73**	**31.23**	**10.61**	**21.72**
Number of Institutions Offering Training Courses on Islamic Finance	59	24	10	80
Number of Institutions Offering Degrees in Islamic Finance	37	4	2	31
Research	**300.00**	**54.54**	**20.03**	**9.23**
Number of Peer-Reviewed / Journal Articles on Islamic Finance (Past 3 Years)	561	70	33	65
Number of Published Research Papers on Islamic Finance (Past 3 Years)	888	104	49	123
CORPORATE SOCIAL RESPONSIBILITY (CSR)	**42.19**	**83.92**	**33.31**	**28.36**
CSR Funds Disbursed	**33.88**	**139.39**	**1.80**	**0.00**
Disclosed Funds Distributed to Charity, Zakat and Qard Al Hasan (US$ Million)	31.40	160.09	2.65	
CSR Disclosure	**50.50**	**28.45**	**64.82**	**56.72**
Average CSR Disclosure Index Score	3.12	1.76	4.00	3.50

GOVERNANCE	**87.91**	**37.80**	**23.83**	**20.15**
Regulation	**100.00**	**33.33**	**33.33**	**0.00**
Islamic Banking Regulations	1		1	
Accounting / Auditing Regulations for Islamic Finance Institutions	1			
Shari'ah Governance Regulations for Islamic Finance Institutions	1			
Takaful / *Re-Takaful* Operators Regulations	1	1		
Sukuk Regulations	1		1	
Islamic Funds Regulations	1	1		
***Shari'ah* Governance**	**103.89**	**51.51**	**14.91**	**13.55**
Centralized *Shari'ah* Committee	1			
Number of Scholars with SSB Memberships	195	89	10	16
Number of Scholars with More Than 5 SSB Memberships		7		
Number of Institutions with More Than 3 SSB Members	53	62	3	7
Corporate Governance	**59.85**	**28.54**	**23.25**	**46.88**
Average Number of Independent Chairman of the Board	1.00	0.12		0.33
Average Number of Independent Directors	4.50	2.50		4.00
Average Disclosure Index Score (Out of 70)	41.58	29.67	46.20	44.83
AWARENESS	**202.31**	**59.00**	**21.84**	**5.10**
Seminars	**181.69**	**8.62**	**11.20**	**4.58**
Number of Seminars (<100 Participants)	51	3	5	10
Conferences	**156.59**	**14.58**	**37.86**	**6.19**
Number of Conferences (>100 Participants)	26	3	10	8
News	**268.66**	**153.81**	**16.46**	**4.53**
Number of Exclusive and Regional News Articles	2371	1682	231	311

Notes: MY – Malaysia, SA – Saudi Arabia, TR – Turkey, UK – United Kingdom.

Source: Thomson Reuters (2018)

FIGURE 43: THE COMPONENTS OF IFDI



Source: Thomson Reuters (2018)

TABLE 29: MACROECONOMIC INDICATORS OF THE SELECTED COUNTRIES

Indicators	Malaysia	Saudi Arabia	Turkey	UK
Population, total (2018)	31,528,585	33,699,947	82,319,724	66,488,991
Population growth (annual %), 2018	1.4	1.8	1.1	0.6
Life expectancy at birth, total (years), 2017	75	75	76	81
Unit of Currency	MYR	SAR	TRY	GBP
GDP (Current US$), 2018	354.348 Billion	782.483 Billion	766.509 Billion	2.825 Trillion
GDP per capita (current US$), 2018	11,239.0	23,219.1	9,311.4	42,491.4
GDP growth (annual %), 2018	4.7	2.2	2.6	1.4
GDP, PPP (current international US$), 2018	999.405 Billion	1.858 Trillion	2.372 Trillion	3.074 Trillion
Consumption (annual variation in %), 2017	6.9	--	6.1	2.1
Government-Consumption, Deflator, 2018	102.013	130.441	664.984	104.748
Unemployment rate, 2018	3.36	6.02	10.93	2.48
Inflation, consumer prices (annual %), 2018	0.9	2.5	16.3	2.3
Interest Rate (%), 2018	3.23	1.19	17.71	0.60
Official exchange rate (LCU per US$, period average), 2018	4.04	3.75	4.83	0.75
Foreign Direct Investment (Million US$), 2018	2,853.634	-18010.4	9,330	15,500
Current account balance (BoP, current US$, Billion)	9.45 (2017)	73.337 (2018)	-27.115 (2018)	-108.745 (2018)
Industrial Production Index, 2018	112.0	132.3	114.0	102.7
Fiscal Balance (% of GDP), 2017	-3.0	-9.2	-1.5	-1.9
Public Debt (% of GDP), 2017	50.7	17.2	28.3	87.1
External Debt (% of GDP), 2018	61	19	61	309
Gross Domestic Income (constant LCU, Trillion), 2018	1.214	2.388	1.694	1.87
Expense (current LCU, Billion), 2017	217.179	722.206	991.907	746.47
Expense (% of GDP), 2017	16	28	31.9	36.4
Labour Force (Total), 2018	15,470,124	14,317,258	32,613,639	34,047,601
Exports of Goods & Services (current US$, Billion), 2018	246.919	310.384	226.982	845.888
Imports of Goods & Services (current US$, Billion), 2018	221.725	209.98	236.01	887.203
Trade Balance, (Billion, 2017)	23.0 US$	98.5 US$	-59.0 US$	-137.0 GBP
Trade (% of GDP), 2018	132.255	66.502	60.403	61.344
Total Reserves (includes gold, current US$, Billion), 2018	101.453	509.469	92.983	172.658
Bank Capital to Assets ratio (%), 2017	11.2	15.4	10.7	6.8
Bank nonperforming loans to total gross loans (%), 2017	1.5	1.6	2.8	0.7
Commercial Bank branches (per 100,000 adults)	10.1 (2017)	8.5 (2017)	17.4 (2017)	25.1 (2013)
Stock Market (annual variation in %), 2017	0.2	--	--	7.6
Ease of Doing Business (Rank)	15	92	43	9
Producer Price Index (PPI)	106.666	116.914	379.253	112.249

Source: The World Bank, Focus Economics, Thomson Reuters

TABLE 30: 2019 INDEX OF ECONOMIC FREEDOM

Indicator	Malaysia	Saudi Arabia	Turkey	The UK
Overall Score	74.0	60.7	64.6	78.9
World Rank	22	91	68	7
Rule of Law				
Property Rights	84.1	55.0	55.8	92.3
Government Integrity	55.4	49.8	41.2	83.8
Judicial Effectiveness	68.2	62.7	49.8	85.9
Government Size				
Government Spending	83.2	57.5	65.1	48.2
Tax Burden	85.6	99.8	76.4	64.7
Fiscal Health	82.4	19.4	92.2	68.6
Regulatory Efficiency				
Business Freedom	83.9	72.3	66.0	92.9
Labour Freedom	74.4	63.3	49.2	73.5
Monetary Freedom	78.6	78.1	70.0	81.2
Open Markets				
Trade Freedom	82.0	76.0	79.6	86.0
Investment Freedom	60.0	45.0	70.0	90.0
Financial Freedom	50.0	50.0	60.0	80.0

Source: www.heritage.org

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