



# The Dynamics of Malaysian *Takaful* Market: Challenges and Future Prospects

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## Abstract

While Islamic finance industry has witnessed a tremendous growth across the globe, one of the markets, *takaful*, still requires attention in order to strengthen their position in the industry as well to increase their market share over their conventional counterparts. In the first part of this study, an overview of *takaful* and Malaysian *takaful* market will be discussed. Next, this paper will deliberate the challenges facing the *takaful* operators in developing the market and lastly, future prospects of *takaful* business will be discussed. This study is important to policy maker, practitioner and researcher who are dealing in Islamic finance, especially the *takaful* market. This study is useful as a guideline to revamp strategies in promoting the market as well as in enhancing the understanding on the local *takaful* market.

*Keywords:* Islamic finance, *takaful*, Malaysia, challenges, issues

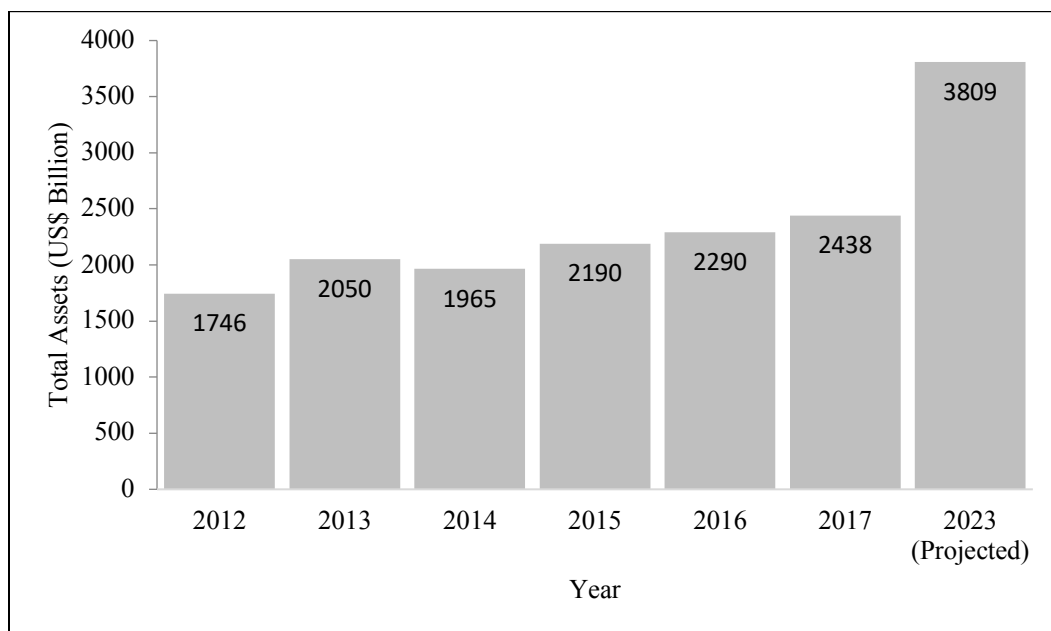
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## 1. Introduction

Islamic finance industry has witnessed a tremendous growth across the globe over the last decade. According to Thomson Reuters (2018), the industry has recorded a compounded annual growth rate (CAGR) of 6% from 2012 until 2017. The substantial growth in recent years was due to the increasing demand from those who are religion-sensitive and more inclined to engage with financial institutions that comply with *Shari'ah* rules (Nomran *et al.*, 2018). Global Islamic finance industry consists of four main markets; banking, *sukuk*, *takaful* and Islamic funds. Among all the markets, banking and *sukuk* are the two main markets that provide significant growth to the Islamic finance industry. According to Islamic Finance News (2018), as at June 2018, global size of Islamic banking assets has reached US\$2.5 trillion. In addition to that, Islamic Financial Services Board (2017) has reported that the volume of annual *sukuk* issuances reached US\$ 75 billion in 2016, bringing the volume of outstanding *sukuk* close to US\$ 320 billion. Nevertheless, *takaful* market, on the other hand, is still small in comparison to other markets, which is estimated to reach the US\$42 billion mark by 2020 (Bank Negara Malaysia, 2015). Several factors are associated with the remarkable growth of the industry, such as improvement in regulatory requirements, enhancement in distribution channel and increasing number of industry players (Ansari and Malik, 2016; Malaysian Takaful Association, 2017; Milliman, 2017). Taking into consideration the performance of each market of the Islamic finance industry and the development of its surrounding ecosystem, Thomson Reuters (2018) projected the industry to grow to more than US\$ 3.8 trillion in assets by 2023. The following shows the global Islamic finance assets growth from year 2012 until 2017 (refer Figure 1).

Figure 1: Global Islamic Finance Industry Assets Growth (2012-2017)



Source: Thomson Reuters (2018)

Although *takaful* contribution is small compared to the other markets in Islamic finance industry, the *takaful* market has gain a great momentum. The *takaful* market still have rooms for further enhancement, especially in Muslim dominated countries. However, several challenges have been identified that would hinder the development of *takaful* market. This study, thus will discuss the challenges facing the *takaful* market and the future prospects of the market.

The remainder of the study is set out as follows. Section 2 is a brief review on *takaful* and Malaysian *takaful* industry. Section 3 provides details of the challenges facing by *takaful* operators in developing the market. Section 4 presents the future prospects of *takaful* business and Section 5 concludes.

## 2. Literature Review

### 2.1 Takaful: An Overview

*Takaful* is originated from an Arabic word '*kafala*' which means "guaranteeing each other" or "joint guarantee". The concept of guaranteeing each other is applied in *takaful* in a way that all the *takaful* participants (known as insured in the conventional counterparts) mutually agree to contribute a sum of money in order to provide financial assistance to other participants, should the participant encounters unfortunate event.

*Takaful* can be divided into two, general and family *takaful*. General *takaful*, also known as general insurance from conventional counterparts provides financial protection to participant for losses arising from perils such as accident, fire, flood, liability and burglary. On the other hand, family *takaful*, also known as life insurance in conventional, provides financial protection to participant from illness, disability and death.

There are few elements that makes *takaful* differs from the conventional such as contracts, rights and obligations of the parties, risk ownership, operation and the nominee status (Sherif and Shaairi, 2013). Whilst conventional insurance contract is a sale and purchase contract of which the insured buys the promise or undertaking by the insurer of compensation in the event of misfortune, a *takaful* contract, as explain earlier is based on a *tabarru'* (donation) and *ta'awun* (mutual co-operation) contracts (Mohd Fauzi *et al.*, 2016, Sherif and Hussnain, 2017). Rights and obligations of the parties also make *takaful* differs from the conventional insurance. In conventional insurance, the relation between insurer and insured is merely a company-client kind of relationship whereby the insurer has to pay compensation to the insured when the catastrophe occurs whilst the insured have to pay the premium. On the other hand, *takaful* operators and

*takaful* participants has a unique relationship whereby in order to fulfil the underlying concept of cooperation and investment, the *takaful* contract is design based on the Islamic principles of contract. The contract however differs based on the business model adopted by the *takaful* operators. For example, if the *mudharabah* contract is applied, the *takaful* operator acts as a trustee and *mudharib* (entrepreneur) of the fund while the participant pays a contribution and takes precautions to safeguard himself. If the *wakalah* model is applied, instead, the *takaful* operator acts as a *wakil* (representative).

As mentioned earlier, *takaful* is operated based on joint guarantee, which all the *takaful* participants bear the risk associated with himself and other participants. Unlike *takaful*, insurer bear all the risk in conventional insurance (Sherif and Shaairi, 2013). Operation of *takaful* operators also differs significantly from conventional insurance. *Takaful* operators need to comply with Islamic law (*Shari'ah*) requirement which prohibits any transactions and activities related to *riba* (interest), *gharar* (uncertainty) and *maysir* (gambling) (Setiyowati, 2016; Hussain and Noor, 2019). The operation of conventional insurance, which engage with non-*Shari'ah* investment activities is one of the factors that involve *riba*. In addition, uncertainty in the outcome and outcome of the contract, as well as uncertainty in the results of the exchange and in the contract period shows the existence of *gharar* in the conventional insurance. Further to that, the element of *maysir* exists in the conventional insurance operation whenever the sum paid out by the insurer exceeds what the insured has paid in premiums (Aziz *et al.*, 2019).

The nominee status also differs in *takaful* and conventional insurance. Unlike conventional insurance where the nominee is entitled to the insurance benefits, a nominee under the *takaful* scheme will receive the benefit only as an administrator and is responsible for the distribution of the benefit based on the Islamic inheritance jurisprudence.

## 2.2 Malaysian *Takaful* Market

Malaysia leads the *takaful* industry in the South-east Asian region. The Islamic finance industry assets are forecasted to account for 40 percent of the banking sector by 2020 (Bank Negara Malaysia, 2015). As of May 2019, there are fifteen *takaful* operators licensed by the Bank Negara Malaysia (BNM), as shown in Table 1. Malaysian *takaful* growth rate is encouraging since 1984. Over the past 30 years, the number of *takaful* operators has climbed from only two operators back in 2003, reflecting the growing popularity of the sector and its increasing importance to the development of Islamic finance.

Table 1: Number of *Takaful* Operators in Malaysia

No	Operator	Ownership
1	AIA PUBLIC Takaful Bhd	Foreign
2	AmMetLife Takaful Berhad	Local
3	Etiqa Family Takaful Berhad	Local
4	Etiqa General Takaful Berhad	Local
5	FWD Takaful Berhad	Local
6	Great Eastern Takaful Berhad	Foreign
7	Hong Leong MSIG Takaful Berhad	Local
8	Prudential BSN Takaful Berhad	Local
9	Sun Life Malaysia Takaful Berhad	Local
10	Syarikat Takaful Malaysia Am Berhad	Local
11	Syarikat Takaful Malaysia Keluarga Berhad	Local
12	Takaful Ikhlas Family Berhad	Local
13	Takaful Ikhlas General Berhad	Local
14	Zurich General Takaful Malaysia Berhad	Foreign
15	Zurich Takaful Malaysia Berhad	Foreign

Source: Bank Negara Malaysia (2019)

The Malaysian *takaful* market has witnessed a steady growth in size of total assets. In 2017 total combined *takaful* assets is RM29.3 billion compared to RM26.8 billion in year 2016. The same pattern was seen in the family and general *takaful* total assets which significantly increased from RM23.2 billion to

RM25.6 billion and RM3.59 billion to RM3.65 billion, respectively (Malaysian Takaful Association, 2017). The combined contributions income has also increased significantly from only RM4863 million in 2011 to RM7534.6 million at the end of 2016. Malaysia is also recognized as the largest *family* takaful market in the world, with a growth rate of 16 percent in 2015 (Global Takaful Report, 2017). In Malaysia, combined contribution of *takaful* business contributes 0.6 percent of gross national income (GNI) with two-third contributed by family *takaful* market. As at the end of 2016, net contributions for family *takaful* stood up at 0.2 percent of GNI compared to 0.1 percent for general *takaful* contribution.

The positive growth of the *takaful* industry in Malaysia are supported by a number of key drivers including the resilient, ever-robust regulatory infrastructure and conducive environment created by BNM. The development of the *Takaful* Operational Framework, Risk-based Capital for *Takaful* (RBCT) and the new Islamic Financial Services Act (IFSA) 2013 also significantly contribute for *takaful* market to flourish. Under the IFSA 2013, the *takaful* sector in Malaysia has to undergo one of the biggest policy changes whereby *takaful* operators need to hold separate capital requirements for its general and family *takaful* businesses. To illustrate, prior to IFSA 2013, a minimum capital requirement of RM100 million is applicable for the combined general and family *takaful* business under the composite structure. However, a separate capital requirement for each entity will be required from July 2018 onwards, whereby a composite company would need RM200 million capital to support its general and *family* takaful businesses. With the separation of *takaful* businesses under different management is expected to result in stronger and sharper business focus.

In addition to that, under the RBCT, *takaful* operators are also required to maintain capital-adequacy levels that are in line with the risk profiles of their operations. These new requirements would affect some of the *takaful* operators whereby additional capital will be required which will result in injections or borrowings to shore up their capital bases. All these new requirements are expected to boost growth of the general *takaful* market, which has largely been overshadowed by *family* takaful. Further, the dedicated and separate general and family businesses will provide greater transparency in the financial strength of each operator as well as the introduction of new products by operators as they compete to strengthen each separate business line.

### 3. Challenges of Takaful

Despite the Malaysian *takaful* market has been enjoying relatively robust growth, it faces a number of challenges to meet its full potential, as outlined below.

#### 3.1 Lack of awareness

Low levels of public awareness is a number one challenge facing *takaful* operators (Hameed *et al.*, 2017). In Malaysia, various literature have been documented that lack of awareness is one of the factors that hinders further development of *takaful* market (Hassan *et al.*, 2018; Salleh and Laksana, 2018). Various campaigns and programmes, which can be divided into five pillars of execution which includes media plan, community engagement, lecture series and collaboration with other organization have been initiated with the aim to increase public awareness on *takaful* (Malaysian Takaful Association, 2017). For example, under community engagement, Malaysian Takaful Association and Etiqa Takaful Berhad have jointly organized the *Jalinan Takaful Iftar Ramadhan* event on 12 June 2017 with the aim of engaging the targeted communities to create *takaful* awareness within their locality. Further, under lecture series, lectures were conducted at several chosen local universities throughout the year (Malaysian Takaful Association, 2017).

#### 3.2 Low Penetration Rate

As of 2018, *takaful* penetration rate stood at 15.2%, which is slightly increase from 14.5% a year before (Ching, 2019). However, the penetration rate is still considered to be low, especially in the bottom 40 household income segment. Malaysians are categorized into three different income groups; Top 20% (T20), Middle 40% (M40), and Bottom 40% (B40). According to the Department of Statistics Malaysia (DoSM), as of 2017, the median and mean household income for T20 is RM13,148 and RM16,088 respectively. In addition to that, the M40 median and mean household income is registered at RM6,275 and RM6,502

respectively. On the other hand, B40 median and mean household income is registered at RM3,000 and RM2,848 respectively. The income group indicator will change over the years and represents the purchasing power and economic growth of the country. According to Bank Negara Malaysia (2018), compared to the general insurance and *takaful*, life insurance and family *takaful* penetration rate is lower among B40 with only 30.3% owning a policy.

### 3.3 Inadequate Technology Capabilities

In this digital age, technology has changed the way human live, the way human save, and the way human bank. But it seems that little has changed in the Malaysian *takaful* market. According to Ernst and Young (2015) and Ezamshah (2016), Malaysian *takaful* operators need to invest in appropriate technology platform in order to have effective interactions with customers across product areas and locations.

### 3.4 Shortage of Talent

Shortage of talent and manpower is a long time issue in Malaysian *takaful* market (PwC, 2008; Ernst and Young, 2015; Daud *et al.*, 2018). According to PwC (2008), *takaful* industry is facing a severe shortage of qualified staff who are able to understand both technical insurance principles and have an adequate awareness of Islamic law and finance. Ernst and Young (2015) further reported that getting people with the right skills is a challenge, especially those with financial reporting, analytical and business acumen skill.

## 4. The Prospects of *Takaful* in Malaysia

In order to become a game changer, *takaful* must be able to penetrate the large market and enough audience. According to DeSilver and Masci (2017), Muslims will form 29.7 percent of the world's population and will reach 2.76 billion by 2050. Whilst *takaful* is marketed as an Islamic alternative to conventional insurance, increasing number of Muslim populations will give an added advantage, so as to increase *takaful* market share. In Malaysia, there were approximately 19.5 million Muslim adherents, made up 61.3 percent of the population. Thus, there's huge opportunity to tap the market.

Statistically, the percentage of Internet users in Malaysia has increased from 76.9 percent in 2016 to 87.4 percent in 2018, with smartphone is the most popular device used (Malaysian Communications and Multimedia Commission, 2018). Specifically, the penetration rate of smartphone users in Malaysia grew by 7.2 percent from 68.7 percent in 2016 to 75.9 percent in 2017 (Malaysian Communications and Multimedia Commission, 2017). This shows that consumers are becoming more digitally-savvy making the marketing, offering and participating to *takaful* products easier. Thus, *takaful* operators need to pay full attention to the digitalization strategy and taking advantage of consumers' evolving behaviour. By adopting digitalization strategies, this will not only encourage productive innovation that will drive costs down but at the same time, improve the quality of service to customers. To illustrates the digitalization strategy, one can look into the effort made by Salaam Bank which working on "an Islamic finance platform that will give people from the United States to Jakarta, Dubai and London access to Islamic finance options that are technologically innovative while creating a bank beyond borders" (Islamic Financial Services Board, 2017).

## 5. Conclusion

*Takaful* is an insurance scheme that is operated and approved by the Islamic law. *Takaful* market in Malaysia, although relatively young, has enjoyed robust growth. Although the Malaysian government is committed to promote *takaful* and to make Malaysia a *takaful* hub in South-east Asia, few challenges have been identified that may hinder *takaful* market development in the country. The challenges range from lack of awareness, low penetration rate, inadequate technology capabilities and shortage of talent.

Several strategies can be implemented in reducing the gap. First, further efforts should be taken in educating potential consumers and promoting the *takaful* market. One of the ways is incorporating *takaful* education syllabus with the aim to educate the youngsters on the important of having financial protection. This initiative not only able to enhance *takaful* awareness but also increase future *takaful* penetration rate.

Second, as number of smartphone users increases over time, promoting *takaful* market and creating *takaful* awareness via smartphone advertising, or also known as mobile advertising, may help. Third, in order to reduce the gap in talent shortage, the industry players must play greater role in designing and strategizing human capital. One way to increase the number of talent is by offering competitive remuneration. As spoken by Tan Sri Muhammad bin Ibrahim, the 8th and current Governor of the Central Bank of Malaysia in his remarks at the Takaful Annual Dinner and Awards 2018, the remuneration of employees of *takaful* operators is not competitive. He further mentioned that among the highly skilled employees, those working in *takaful* earn 15% less than those in conventional. Therefore, as long as this gap exist, shortage of *takaful* talent will remain. Another possible effort that should be taken to minimize the shortage of talent is to ensure graduates from the certified programs such as the Chartered Professional in Islamic Finance, Certified *Shari'ah* Advisor and Certified *Shari'ah* Practitioner is ready and able to join the *takaful* workforce.

Moving forward, the sustainability for Malaysia's *takaful* industry will demand the adoption of best practices and rapid adaptation to change in meeting customers' needs.

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