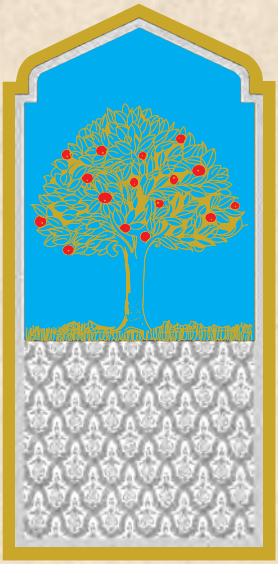

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DOES THE MUTUALITY CONCEPT UPHOLD IN THE PRACTICES OF *TAKAFUL* INDUSTRY?[1]

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Abstract

Even though the development of takaful industry is very encouraging and variety of takaful models have been implemented, the industry still faces a lot of issues and challenges especially in the Shari'ah and operational matters. This paper discusses the current development of takaful industry in Malaysia and highlights the major issues and challenges in developing a resilient takaful market especially in upholding the mutuality and cooperative concept. Interviews with several experts from the takaful industry and academician from several universities have been conducted to study their views on the discussed matters. The study found that existing takaful models inclined towards more business oriented in order to fulfill the expectation of shareholders. Various issues in existing practices such as wakalah fee, tabbaru' issue, ownership of return and underwriting surplus issues were among the issues that lessened the spirit of mutuality in takaful. This paper also found that the major issues in existing takaful models derived from juristic difference among scholars. There are also efforts taken by several parties to harmonize these by going back to the basic of takaful, which are brotherhood, mutual assistance and cooperation.

Keywords: cooperative, mutuality, *mudarabah, takaful* industry

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1.0 Introduction

The Malaysian Islamic Financial Service Act (2013) defines *takaful* as a scheme based on brotherhood, solidarity and mutual assistance which provides financial assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose. AAOIFI[2] also highlights the same when *takaful* is defined as an agreement between persons who are exposed to risks to protect themselves against harm arising from risk by paying contributions on the basis of a "commitment to donate". From the definition, it is clear that the concept of *takaful*, provides protection to the participants against any misfortune through mutual assistance and mutual sharing of risk. *Takaful* is based on the principles of mutual cooperation and shared responsibility for the protection of members if any loses happened[3]. It means that, under the *takaful* practices, members or participants of society mutually and voluntarily agree to contribute sum amount of money to *Shari'ah* support the members of the group in relation to specific needs.

Takaful and insurance share the same approach in conducting their business where both depend on the concept of pooling money from the customer for the sake of helping the unfortunate of other in the event of encountering financial loss. However, unlike insurance, *takaful* model is different in many ways; *takaful* is constructed based on the principle of sharing risks while the latter is based on transferring risk principle. On top of that, *takaful* funds are also divided into risk fund and investment fund in order to avoid the issue of uncertainty in the *takaful* contract. Based on these features, *takaful* operators run the business of providing mutual protection and investment to the customers by way of sharing risks.

Even though the development of *takaful* industry is very encouraging and variety models have been implemented in *takaful* products, but the industry faces a lot of issues and challenges especially in term of model selection. Some scholars disagree with the model of *mudarabah* due to few issues such as surplus

[2] Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), *Shari'ah Standards,* (Manama: AAOIFI, 2010)
[3] W. J. Kwon, "Islamic principle and takaful insurance: re-evaluation", *Journal of Insurance Regulation,* 26(1), (2007), 53.

distribution in investment account[4] and the ownership of the underwriting surplus[5]. In current *takaful* practises, the percentage of profit distribution method is decided by the shareholders whereas policyholders do not have any right to do so. It is widely accepted that underwriting surplus cannot be described as a profit for the *takaful* company since the surplus is derived from the contributions. However, there are some fatwas issued by *Shari'a*h boards that permit *takaful* operators (shareholders) to share underwriting surplus with the policyholders. In order to give incentive for prudential underwriting practice, some percentage of underwriting surplus can also be given to the operator, depending on the level of the performance[6].

Not only *mudarabah* model, but other scholars against the model of *wakalah* as practiced in Malaysia *takaful* industry because it would give more returns to the *takaful* operators and this defeat the basic purpose of mutual cooperation in *takaful*. There is also a claim made by some scholars which opines that the *wakalah* fee is charged many times in the *takaful* contract; *takaful* operator charges *wakalah* fee on contribution and later they also charge a *wakalah* fee on the value of investment[7]. The debate on the validity and the marketability of *mudarabah* and *wakalah* in *takaful* have initiated other *takaful* operators to implement other *Shari'ah* compliant contracts that suits *takaful* model. All of these issues may arise the issue of business-oriented mindset has captured the practice of *takaful* industry. Hence, the article aims to study how these models contribute to the cooperative and mutual spirit of *takaful* from the experts' point of views.

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[4] S. Al-Ali, "Sharing of underwriting surplus in *Takaful* operation: practical perspective", *proceedings from the International Conference on Islamic Banking and Finance (IBAF),* (Kuala Lumpur, 2010).

[5] Y. Soualhi, "*Shari'ah* inspection in surplus distribution: *Shari'ah* views and their current implementation", International *Shari'ah* Research Academy (ISRA) Islamic Finance Seminar (IIFS), (Kuala Lumpur, 2008).

[6] E. H. Sutan, "Issues surrounding management of *takaful* surplus", presentation at the Islamic Finance University College of Bahrain, (2012).

[7] A. Z. Rahman & H. Redzuan, *Takaful: the 21st century insurance innovation,* (Malaysia: McGraw Hill, 2009).

2.0 Literature review

Takaful is an Arabic word derived from the word '*kafala*' which means to take care of one's needs, whereby a group of participants agree among themselves to support one another jointly for the losses arising from specified risks[8]. The basic idea of the *takaful* in financial transaction is a mutual cooperation between two parties to protect one another from unexpected future risk[9]. This definition is in line with the definition by IFSB[10], which stated *takaful* as a group of participants agree among themselves to support one another jointly against a defined loss. In a *takaful* arrangement, the members or participants contribute money as a charitable or *tabarru'* commitment in a *takaful* fund that will be used to assist them against a specified type of loss or damage. The underwriting in a *takaful* is thus undertaken on a mutual basis, similar in some respects to conventional mutual insurance.

While based on IFSA[11], *takaful* is defined as a scheme that is based on brotherhood, solidarity and mutual assistance which provides mutual financial aid and assistance to the participants in facing predetermined situations whereby the participants mutually agree to contribute for that purpose. *Takaful* is also defined as a *Shari'ah* compliant insurance. The term is an extension of previous definition given by previous *Takaful* Act (1984), which clearly stated in Section 2, that a *takaful* business involves aims and operations that do not involve any elements not approved by the *Shari'ah*. *Takaful* is based on the principles of mutual cooperation and shared responsibility for the protection of members if any loses happened[12]. It means that, under the *takaful* practices, members or participants of

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[8] K. M. M. Ali, "Basis and models of *Takaful*: The need for *Ijtihad*", *takaful* articles by ICMIF *Takaful*, (2010).

[9] M. Billah, *Applied Islamic law of trade and finance: A selection of contemporary practical Issue*s, 3/e, (Malaysia: Sweet and Maxwell Asia, 2007).

[10] Islamic Financial Services Board and International Association of Insurance Supervisors, "Issues in Regulation and Supervision of *Takaful* (Islamic Insurance)", (August, 2006).

[11] Islamic Financial Services Act 2013. Kuala Lumpur, Bank Negara Malaysia.

[12] Kwon, op. cit, 55.

society mutually and voluntarily agree to contribute sum amount of money to *Shari'ah* support the members of the group in relation to specific needs.

Even though both *takaful* and insurance share the same approach in conducting their business where both depend on the concept of pooling money from the customer for the sake of helping the unfortunate of other in the event of encountering financial loss. However, unlike insurance, *takaful* model is different in many ways; *takaful* is constructed based on the principle of sharing risks while the latter is based on transferring risk principle. On top of that, *takaful* funds are also divided into risk fund and investment fund in order to avoid the issue of uncertainty in the *takaful* contract. Based on these features, *takaful* operators run the business of providing mutual protection and investment to the customers by way of sharing risks.

As for Khorsid [13] *takaful* is a mutual activity which compensates members that are in difficulties. A group of people that have similar risk and work in same risk nature creates mutual *takaful* in order to protect their group interest. Sudan which is known as the first country that established *takaful* company use mutual basis concept (cooperative) in the *takaful* business model. The Sudanese *Takaful* Insurance Act of 2003 defines the cooperative insurance contract as "a contract whereby the insurer undertakes to pay to the insured a given sum of money when an accident occurs against premiums paid by the insured to the insurer on the basis of a donation contract".

The mutual concept in *takaful* was also being practiced in conventional insurances. History has shown that the mutual insurance concept started in 17th century which was initiated by a group of farmers in England. They created mutual insurance among them to cover their loss in plantation due to fire and other mishap. The same also happen in US, where the first mutual insurance company in the U.S. was The Philadelphia Contributionship, which was initiated by Benjamin Franklin in 1752. In general, the characteristics of mutual insurance/*takaful* companies are:

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[13] A. Khorshid, *Islamic Insurance: A Modern Approach to Islamic Banking*, (New York: Routledge Curzon, 2004).

1. common equitable ownership of the assets by members;
2. the right of policyholders to be members and the exclusion of others and to choose management;
3. the sole business purpose of supplying insurance/*takaful* at cost; and
4. the right of members to the return of premiums which are in excess of the amount needed to cover losses and expenses[14].

Based on the above characteristics, it can be concluded that the mutual insurance/*takaful* companies are owned and managed by policyholders that contributed a specified amount of premium or capital. Once a person purchases an insurance/*takaful* policy from mutual insurance/*takaful* companies, he becomes the holder of the insurance policy and he is also the holder for the ownership of the company.

2.1 Development of Takaful Industry

In the modern practices of insurances, *takaful* is claimed to have its first emergence in Sudan in 1979 and then, is making its way throughout the world. The main reason of the introduction of *takaful* in Sudan is due to Muslim scholars have realized that the conventional insurance does not fulfil *Shari'ah* compliance concept and Islamic ethics[15]. Scholars confirmed that conventional insurance

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[14] L. G. Louis, M. Claude, V. Jonathan & C. V. Marie, "Voluntary Contributions to a Mutual Insurance Pool", *Journal of Public Economic Theory*, 19(1), (2017), 198-218. .

[15] S. U. Farooq, T. S. Chaudhry, F. Alam & G. Ahmad, "An analytical study of the potential of *Takaful* companies", *European Journal of Economics, Finance and Administrative Sciences*, 20, (2010), 54-75; A. R. Wahab, M. K. Lewis, M. K. *Hasan*, "Islamic *Takaful*: Business models, *Shari'ah* concerns, and proposed solutions", *Thunderbird International Business Revie,*. 49(3), (2007), 371-396; D. Y. Taylor, "Ten-year master plan for the Islamic financial industry (Takaful)", paper presented for the Islamic Financial Services Board (IFSB), (2005); Islamic *Fiqh* Academy, *Resolutions and recommendations of the Council of the Islamic Fiqh Academy 1985 – 2000*, Jeddah: Islamic Research and Training Institute Islamic Development Bank, 2000); R. C. Maysami & W. J. Kwon, "An analysis of Islamic *Takaful* insurance: A cooperative insurance mechanism", *Journal of Insurance Regulation*, 26(1), (199), 109-132.

are *fasid* (invalid) because of the implementation of premium that involved with the elements of *gharar* (uncertainty), *maysir* (gambling) and *riba* (interest).

The *Fatwa* Committee of the National Council for Islamic Religious Affairs Malaysia issued a fatwa on 15th June 1972, which highlighted that conventional life insurance contradicts the *Shari'ah* or Islamic rules[16]. A similar decree that rules the conventional insurance as *haram* or unacceptable was made by the Council of Islamic *Fiqh* Scholars in 1975. Thus, more than 10 years later, the first *Takaful* Act was force. The establishment of *takaful* industry in Malaysia started in 1985 when *Takaful* Act 1984 came into force for the regulation. Since that the *takaful* industry in Malaysia has growth from only one *takaful* operator which is *Takaful* Malaysia Berhad to eleven *takaful* operators in year 2018 where family *takaful* business accounting for 30% of overall life market and general *takaful* business represents 12% of overall general *takaful* business.

2.2 Takaful Models

This research only focused in four main models that consistently used by most of the *takaful* operators in Malaysia. These models are *mudarabah takaful* model, *wakalah takaful* model, hybrid model and *waqf* model.

2.2.1 Mudarabah Takaful Model

The earliest *takaful* model in Malaysia is the *mudarabah* model[17]. In this model, the participants contribute to the Family *Takaful* Fund. The savings and investment will be credited into the Participant's Account (PA) while the donation into the Participant Special Account (PSA)[18]. Bank Negara Malaysia[19] deduces that both the PA

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[16] Bank Negara Malaysia, "Introduction to *Takaful* Operations", presentation by BNM, Kuala Lumpur, (July 17, 2008)

[17] C. S. Macey, "An overview of Islamic insurance", London: The International Cooperative and Mutual Insurance Federation (ICMIF), (2008), https://www.celent.com/insights/984032433, accessed on Oct. 13, 2018; M. A. Laldin, "Islamic Financial System: The Malaysian Experience and the Way Forward", *Humanomics,* 1(3), (2008), 217-238.

[18] E. R. A. Engku Ali & H. S. P. Odierno, *The philosophy and Shariah Principle in Takaful*, (Kuala Lumpur: CERT, 2008).

and PSA must be invested in *Shari'ah* compliant investments by the *takaful* operators. Any profit will be shared between the participants and the *takaful* operator according to the ratio agreed upfront. The PSA account will be used for claims, reserves and others expenses. Whereas the PA will be accumulated and then paid together with the coverage amount from the PSA to the participants upon maturity or claim.

The contribution of participants and investment income can be used for the payment of claims, re-*takaful* costs and other expenses occur[20]. While the overall surplus in the *takaful* fund is than shared between the participants and shareholders in a defined proportion, he added that the shareholders are responsible for the expenses related to management and marketing expenses to their share and the profit generated from the investment.

However, in case of loss, Htay and Salman[21] stated, "in the event of loss or deficit of the *takaful* fund, the entire loss is borne by the participants". One distinctive feature in practice is that the shareholders shall provide free-interest loan (*qard al-hasan*) in order to overcome deficit in the participants' special account (PSA)". Then the *qard al-hasan* will be paid from the surplus fund and *takaful* operator should not charge any fee from the management fee for the fund of the participants and operation cost will be borne by the shareholders' fund.

Mudarabah model in *Takaful* defined as a partnership between operator and capital provider. In this partnership the operator is holding a role as an entrepreneur (*mudarib*) who is entrusted to manage the *takaful* business and the participant(s) as the capital provider, called *sahib al-mal* who is obliged to pay the *takaful* contribution as the capital[22]. The strength of *mudarabah* model where

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[19] Bank Negara Malaysia, *Guidelines on Takaful Operational Framework*, (Kuala Lumpur: BNM, 2010).

[20] A. R. A. Wahab, "*Takaful* Business Models - *Wakalah* based on *Waqf*", in *Second International Symposium on Takaful*, (2006), 4.

[21] S. N. N. Htay & S. A. Salman, "*Shari'ah* and Ethical Issues in the Practice of the Modified *Mudharabah* Family Takaful Model in Malaysia", *International Journal of Trade, Economics & Finance*, 4(6), (2013), 340-342.

[22] M. F. Yusof, W. Z. I. W. Ismail and A. K. M. Naaim. *Fundamentals of*

the *takaful* operator or *mudarib* is responsible in protecting the business. Therefore, they are entitled to have a portion of the profit as predetermined during entering into the contract such as 50:50, 60:40 dan70: 30 ratios[23].

Yusoff[24] stressed on the matters related to the costs of conducting the *takaful* partnership where any costs associated with the management expenditure is borne by the operator or owner of the company. Furthermore, in protecting capital providers, this arrangement obliges the manager to be liable in the event of negligence and misconducts in the discharge of his functions[25]. On the other hand, Soualhi[26] highlighted the weakness of *mudarabah* model in *takaful* where any losses are to be fully borne by the capital provider with the exception of cases of willful negligence or misconduct by the *mudarib*.

2.2.2 Wakalah Model

In *wakalah takaful* model, *takaful* operator acts as a wakil (an agent) for the participants. Then, wakil will manage the fund into specific investment account. Under *wakalah* the participants remain the actual owner of *takaful* funds and surplus will be invested in *Shari'ah* compliant activities[27]. Nowadays, *wakalah* model seems to have become the most widely applied arrangement for *takaful* industries[28].

In the pure *wakalah* model, the investment or savings portion will be credited to the PA account and the donation will be credited

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Takaful, (Kuala lumpur: IBFIM, 2011).

23 Ibid.

24 M. F. Yusoff, *The Concept and Operational System of Takaful Business*, (New Horizon, 1996), 10-14.

25 A. Khorshid, op. cit.

26 Y. Soualhi, "*Shari'ah* Inspection of Surplus Distribution in *Takaful* Operations", IIUM *Journal of Economics and Management*, 18(2), (2010), 197–220.

27 M. Selim, "Providing Insurance Products by Issuing Sukuk with Joint Ownership and Risk Sharing", Proceedings of the 9^{th} *Asian Business Research Conference*, (Dhaka, Bangladesh: BIAM Foundation, 20-21 December 2013)

28 S. Archer, R. Ahmed, V. Nienhaus, T*akaful Islamic insurance: concepts and Regulation Issues*, (Singapore: John Wiley & Sons, 2009), 16-17.

into the PSA[29]. Here, all the underwriting surplus and investment profits belong to the participant. The *takaful* operator in *wakalah* model simply earns their income from the *wakalah* fee[30]. They do not share in the underwriting surplus.

Rahman and Redzuan[31] however believe that the *wakalah* fee is charged two times. There are actually, (1) *wakalah* fee on contribution, and (2) *wakalah* fee on value of investment. On the other hand, Bank Negara Malaysia[32] mentions that for products based on the *wakalah* contract, a fixed upfront fee can be charged on the contributions based on contractual terms entered with the participants. The *wakalah* fee is to cover commissions and management expenses incurred in the management of *takaful* funds. It does not specifically explain anything against charging the *wakalah* fee more than once.

Operationally, under *wakalah* model, an agency relationship is created and entered into by two parties to undertake certain business. Based on this premise, the model describes an agency agreement between the operators, acting as the agent or "*wakil*" to the participant as the principal to manage the participant of the latter in a variety of *takaful* products provided by the operator[33]. One major issue still under deliberation involves the distinction between the pure *wakalah* model (where the operator charges a fee for services) and recently modified approaches where, within a *wakalah* model, a percentage share of the underwriting surplus is paid as a performance incentive for the operator[34]. According to Saifudin[35], the advantages of *takaful wakalah* model among others are:

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[29] T. Frenz & Y. Soualhi. *Takaful and Retakaful: Principles and Practices*, (Kuala Lumpur, Malaysia: Munich Re Retakaful, 2010).
[30] A. Z. Rahman & H. Redzuan, op. cit.
[31] Ibid.
[32] Bank Negara Malaysia, op. cit.
[33] M. F. Yusof, W. Z. I. W. Ismail, and A. K. M. Naaim, op. cit.
[34] A. R. Wahab, M. K. Lewis & M. K. Hasan, op. cit., 396.
[35] M. Saifudin. *Kelebihan model Wakalah dalam Takaful*, (2010), accessed on 14 October 2018, http://ustazsaifudin.wakaf.org/v1/2010/05/06/kelebihan-model-wakalah-dalam-takaful/

i. It is an important and faster marketing tool for accelerating and expanding market.
ii. It provides better service to the clients through agents provided that agent is able to provide the best service and advice to clients,
iii. It brings low overhead cost to the company as opening branch in every district is no more relevant as the agents can play their roles in marketing the *takaful* products.
iv. *Takaful* operator able to manage and anticipate the administrative costs efficiently as the cost is budgeted earlier as fixed agency fees.

2.2.3 Hybrid Model

In the hybrid model, there are combinations of two different models which are *wakalah* and *mudarabah* models. It also been called as *wakalah mudarabah* model. In this kind of contract *wakalah* can be used for underwriting activities related to the risk assessments, re-*takaful* and return for claim management. Then as aforementioned in the contract of *wakalah* model, *takaful* operator acts as the *wakil* of the contributed fund and can only obtain specific charges from an agreed fee. However, the *wakalah* fee may differ and can be based on the *takaful* operator's performance[36].

With regard to underwriting activities, the *takaful* company act as the *wakil* (agent) on behalf of participants to manage their funds. *Takaful* company will receive contribution, pay claims, arrange re-*takaful* and all other necessary actions related to *takaful* business. In exchange for performing these tasks, the company charges each participant a fee known as a *wakalah* fee, which is usually a percentage of the contribution paid by each participant.

On the other hand, the *mudarabah* contract is used in the investment side and the *takaful* operator act as *mudarib* (manager) on behalf of the *takaful* participant. In order to satisfy the *Shari'ah* requirement, the ratio of profit is fixed and agreed upon between the two parties at the beginning of the contract. They will share any

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[36] E. R. A. Engku Ali & H. S. P. Odierno, op. cit.; I. Asaria, "The spirit and models of takaful: meeting of minds or parting of ways?", *New Horizon,* Vol.172, (2009), 38-40.

profit generated from the participants' investment account accordance the profit ratio[37].

Therefore, experts on this model argue that a *mudarabah* arrangement is better and suit management and investment of *takaful* fund[38] and it provides incentive to *takaful* operator to optimize its return by sharing profit. The *wakalah* model is perhaps better than the *mudarabah* for managing the *takaful* business for the agency fee (cost of insurance). It is more transparent and it is free from the controversial charging of expenses (including marketing commissions) to the *takaful* fund[39].

2.2.4 Waqf Model

In explaining the practices of *waqf*, according to Cizakca[40] there are three kinds of *awqaf* in Islam: religious *awqaf*, philanthropic *awqaf*, and family *awqaf*. In modern context, the objective of the creation of *waqf* fund is to provide relief to participants against defined losses as per the rules of the *waqf* fund. Many examples of cash *waqf* funds exist to give interest-free loans or to handle monies given to manage where the returns may be used for social benefits. The fund may be managed on a commercial basis for a fee by a fund manager or an administrator appointed for this purpose[41]. However, no literature related to the *waqf takaful* model can be found under Malaysian practice, as the *Takaful* company is introducing *waqf* as a way to donate to the society only. For instance, *Syarikat Takaful* Malaysia has introduced *takaful* endowment in 1997, which is a form of *waqf* cash[42] and the aim of introducing it is to provide the participants *takaful* the facility to continue their contribution in the event of their

[37] H. A. Al-Nemer, "Participants' Knowledge and Educational Background about Takaful Products & Services: An Empirical Study on Saudi Arabia", *International Journal of Business, Economics and Law*, 7(1), (Aug. 2013), 43-53.

[38] M. Obaidullah, *Islamic financial services*, Islamic Economic Research Centre, (Jeddah: King Abdul Aziz University, 2005), 148.

[39] W. Akhtar, *Takaful Models and Global Practices*. (Lahore, Pakistan: COMSATS Institute of Information Technology, 2010).

[40] M. Cizakca, "*Awqaf* in history and its implications for modern Islamic economics", *Islamic economic studies*, 6(1), (1998), 43-70.

[41] A. R. Wahab, M. K. Lewis & M. K. Hasan, op. cit, 377.

[42] A. Z. Rahman & H. Redzuan, op. cit.

misfortune[43]. However, by looking deeper into the concept, there are many advantages of *Takaful waqf* as it promotes the protection based on the relationship of human brotherhood, mutual responsibility among the participants and collaborative efforts between them.

According to Yusof[44] for *waqf* model, a *waqf* account has to be established by the *takaful* operator. The shareholders invest their capital in the *takaful* company as *waqf and some of the contribution received from the takaful participants also will be channeled into this account.* All expenses shall be charged to the *waqf* fund. As a manager, the *takaful* operator will perform all functions necessary for the operations of the *waqf. As wakel (agent),* a w*akala* fee to be deducted from the contribution paid by the participants. As *mudarib*, the operator will manage the investment of the *takaful* fund.

2.3 Issues in Takaful

Though the *takaful* industry is undergoing a period of rapid development and growth, it faces a lot of issues and challenges such as the issue of surplus distribution issue[45]. The existing models of *takaful* have been practiced by *takaful* operators in a way they have been criticized for imposing terms and conditions that are not sufficiently covering the needs of the participants. On the other hand, Htay & Zaharin[46] stated that *wakalah* fees imposed on the participants are too much and at too many layers that caused disadvantages to the participants. In which it shows obviously that *takaful* company is too profit oriented and less considering the *taawuni* spirit.

Among the controversial practices of the *wakalah* fee, involves the upfront charge where according to actual principles of accounting, the *takaful* operator is entitled to earn *wakalah* fee at the

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[43] M. Saifudin, op. cit.
[44] M. F. Yusof, W. Z. I. W. Ismail and A. K. M. Naaim, op. cit.
[45] S. Al-Ali, op. cit,; T. Frenz & Y. Soualhi, op. cit,; T. Frenz, op. cit.; Y. Soualhi, op. cit.; H. S. P. Odierno, *The Sharing of Surplus in Takaful*, (December, 2006), accessed on 18 October 2018 http://www.actuarialpartners.com/wp-content/uploads/2011/12/2008-Takaful-MIIR-Surplus-Sharing-Hassan.pdf
[46] S. N. N. Htay & H. R. Zaharin, "Critical Analysis on the Choice of Takaful {Islamic Insurance} Operating Models in Malaysia", (2011).

end of *takaful* period only for a particular year to declare it as income[47]. With regards to the issue in profit sharing, Akhtar[48] critics on the issues of profit sharing where it is illegal for participants as well as for *takaful* operators to share in profits as in the case in *mudarabah* model. For participants, the issue arises as a result of *tabarru* nature of contribution. The numbers of *Shari'ah* scholars view that, participants pay the contribution as donation so from *Shari'ah* point of view, they cannot receive any profit from donated amount. Similarly, since *takaful* operators acts as a trustee and manager of funds and its responsibility is to act in the best interests of shareholders. The remuneration and salaries of managers are fixed and approved by board of directors, so *takaful* operator should not be allowed to share the profit but only entitled to fixed charges. The same issues arise for modified *mudarabah* model.

On the issue of underwriting surplus sharing is similar to that of profit sharing. *Shari'ah* scholars argue that participants are not allowed to share the surplus of the risk fund (*takaful* contribution) which they have already paid as a donation. Similarly, *takaful* operators have no right to share the surplus amount as they have already received *wakalah* fee or their share of profit. Now the question arises if neither participants nor *takaful* operator has legal right on the underwriting surplus, where this amount should go. Few *Shari'ah* scholars view that this amount should be channeled to *waqf* fund for charitable purpose and should be used for the welfare of poor and needy people of the society who are not real members of *takaful* company. Besides that, other scholars propose that underwriting surplus could be returned to the participants as *hibah* (gift)[49]. This argument was supported by Htay and Salman[50] mentioned, "surplus sharing can be seen as an incentive for the *takaful* operator for their *takaful* funds". However, according to the discussion of *Shari'ah* Advisory Council (SAC) in 62nd meeting on 4th October 2006, stated that channeling any underwriting surplus as profit sharing is not in line with *Shari'ah* principles and it contradicts

[47] W. Akhtar, op. cit.
[48] Ibid.
[49] S. N. N. Htay & S. A. Salman, op. cit., 341.
[50] Ibid.

the *mudarabah* principles. In practicing in such a manner, it turns the concept of *takaful* contract, which is cooperative in nature, into a business for purely commercial purposes.

On a few occasions, *Shari'ah* scholars discussed the ownership of the underwriting surplus, for example to whom the underwriting surplus belongs to[51]. Soualhi explained that the Middle Eastern scholars and Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) did not allow *takaful* operators to share the underwriting surplus. It can be seen at Paragraph 5/5 of AAOIFI Standards on *takaful*: "The adopted rules may comprise disposal of the surplus in a way that serves the cause of common interest of the participants, such as accumulation of reserves, reduction of the contribution, charitable donations and partial/full distribution of the surplus among the participants. The managing company is not entitled to any share of the surplus[52]".

The AAOIFI Standards can be seen as a counter argument to the Malaysia approach. However, some other scholars approve the practice. For example, Islamic Financial Services Board[53] permitted the sharing of underwriting surplus but ironically, they seem to discourage the practice as well. The reason that they are against this principle is that it would give higher returns to the *takaful* operators and become unfair to the participants. *Shari'ah* scholars believe that this practice would defeat the whole purpose of *takaful* as they see it as an attempt by the *takaful* operators to earn more through spreading the earnings. Bank Negara Malaysia[54] however does not see it as an issue and classifies that the *takaful* operators can earn profit through the charge of upfront fees (*wakalah* fee), profits from participants' fund and surplus on investment profits.

Another issue in *mudarabah* model is benevolent loan. Under this model, the shareholders are responsible to provide *qard al-hasan* loans to the participants in the event of any deficit in the PSA fund.

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[51] Y. Soualhi, op. cit.
[52] Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI), *Shari'ah Standards*, (Manama, Bahrain: AAOIFI, 2015).
[53] Islamic Financial Services Board (IFSB), *Guiding Principles on Governance for Takaful (Islamic Insurance) Undertakings,* (Kuala Lumpur, IFSB: December 2009).
[54] Bank Negara Malaysia, op. cit.

However, the terms and conditions of *qard al-hasan* in terms of repayment and timing of the drawdown are not certain and clear[55]. Onagun[56] mentioned that there is difficulty to know on how to maintain fairness in the different generations of participants. It is because the new participants may be adversely affected with by paying higher contribution or receives small or no underwriting surplus due to the need of making repayments of *qard al-hasan*. The participants never know whether TO manage the fund wisely or not. It must be noted that the setting of contribution levels must not be higher fee due to support the *qard al-hasan* loan, otherwise this will defeat the purpose of *qard al-hasan* as a benevolent or interest free loan. This practice has been discussed and mentioned in the *Shari'ah* Resolutions in Islamic finance issued by the Bank Negara Malaysia as one of the mechanisms to overcome deficit in the Participant Special Account (PSA) fund. Unfortunately, academic study found that Muslim scholars do not agree with the issue of *qard al-hasan* adopted in the *mudarabah* model[57]. The research also found that *takaful* operators are choosing certain models to maximize their self-interest, rather than to fulfill the participants' interest.

A further common issue relates to *qard al-hasan* and the misinterpretation of its' concept[58]. Since *qard al-hasan* is a benevolent loan, it means that under this original principle, the borrower cannot be forced to make repayment. In the event the borrower is unable to settle the loan, the lender must accept this transaction as a charitable act. In the context of *takaful*, this is the main reason why some shareholders are quite reluctant to offer *qard al-hasan* when there is deficit in the *takaful* fund[59].

The above points reflect some of the current issues arising in

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[55] J. Sohail (Ed.), *Islamic Insurance: Trends, Opportunities and the Future of Takaful*, (London: Euromoney, 2007).

[56] A. I. Onagun, "Solvency of *takaful* fund: a case of subordinated *qard*", in proceedings of the *2nd International Conference on Business and Economics Research*, (2011).

[57] S. N. N. Htay & H. R. Zaharin, op. cit.

[58] G. Said Atan. *The Concept of Al-Qard Ul-Hasan*, (2009), accessed on October 14, 2018 https://www.scribd.com/document/22013726/Qard-Hassan

[59] S. N. N. Htay & H. R. Zaharin, op. cit.

the *takaful* industry. Due to the on-going debate concerning profit and surplus issues in *mudarabah* model, the majority of *takaful* operators in Malaysia have now switch from *mudarabah* model to the *wakalah* model after more than two decades applying the *mudarabah* model[60]. In conclusion, Htay and Salman[61] stated that the expansion and development of *takaful* growth is not limited merely in the Muslim countries, but also appears in the non-Muslim countries. However, the *Shari'ah* and ethical issues remain as yet unsolved, so this result will hinder any expansion and development of *takaful* industry. Hence, this is the critical aspect that the *takaful* industry must endeavor to focus on. Though not all the views of the previous literatures are strong and the industry may have their own answers, the issues raised nonetheless still highlight the valid opinions from the experts on existing models in their current form. Hence, we intend to analyze the proposed objective of the article concerning the extent of cooperative versus the commercial nature of *takaful* models.

3.0 Data and Methodology

This paper applies qualitative research approaches through conducts interviews with seven personals from various background with the aim to collect as many as possible data and sources from the informants[62]. In qualitative research, saturation of data is the best criterion to determined sample size. Saturation is defined by many as the point at which the data collection process no longer offers any new or relevant data[63]. In this case, seven informants are sufficient to answer all the objectives in this paper properly. Thus, it's in line with Robson[64] that noted there is no set number of interviews needed for a flexible design study.

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[60] Y. Soualhi, op. cit.

[61] S. N. N. Htay & S. A. Salman, op. cit., 342.

[62] O. Talib. *Asas Penyelidikan, Penulisan Tesis dan Statistik.* (Serdang: UPM, 2013).

[63] K. Charmaz, *Constructing grounded theory: A practical guide through qualitative analysis.* (London: Sage, 2006); J. M. Morse, "The significance of saturation", *Qualitative Health Research*, 5(2), (1995) 147-149; B. G. Glaser, *Emerging vs forcing: Basics of grounded theory analysis*. (Mill Valley, CA: Sociology Press, 1992).

[64] C. Robson, *Real World Research*, 2/e, (Oxford, Blackwell: 2002).

3.1. Respondents

The informants come from various background, which is three from academicians, two from *Shari'ah* scholars and two informants from the experts in *takaful* industry. The details of informants as follows:

(i) Academicians

1. Dr Mohd Azam b Hussein – (UUM).
2. Ustaz Mohammad Ali Jinnah – (ISRA)
3. Dr Azrul Azlan b Iskandar Mirza (USIM)

(ii) *Shari'ah* scholars

1. Dr Zulkifli Hasan (USIM) and *Shari'ah* Advisor MAA *Takaful*
2. Dr. Nurul Aini bt Muhamed (USIM) and *Shari'ah* Advisor Hong Leong MSIG *Takaful*

(iii) Experts

1. Ustaz Wan Jemizan Wan Deraman- (*Shari'ah* Compliant Dept. *Takaful* IKHLAS)
2. Ustaz Saifuddin (*Shari'ah* Department, *Takaful* IKHLAS)

All of the informants have subsequently been renamed as Respondent A, Respondent B, Respondent C, Respondent D, Respondent E, Respondent F and Respondent G, in no particular order. Effort was then made to determine which of their views is the most preferable. According to Sosulski & Lawrence[65], a population is selected because they are considered good sources of information that will advance a study toward a reasonable goal. Face-to-face interviews were meant to seek and thoroughly discuss the practices and issues regarding the matter under discussion. The respondents were selected by using snowball and purposive sampling techniques[66]. Every interview will be conducted for approximately 60

[65] M. Sosulski and C. Lawrence, "Mixing methods for full-strength results: two welfare studies", *Journal of Mixed Methods Research*, 2(2), (2008), 121-148.

[66] D. Silverman, *Doing Qualitative Research: A Practical Handbook*,

minutes, and each will be recorded and transcribed for analysis. All the informants were interviewed within a 6 month period.

4.0 Findings and Discussion

4.1 Expert Views on Existing Takaful Models

All respondents state the structures of current *takaful* models in Malaysia are based either on *wakalah*, *mudarabah* or hybrid (combination of *wakalah* and *mudarabah*). For *takaful* operators each model has some advantages over one another. *Wakalah* for instance offers fixed returns to *takaful* operators in term of *wakalah* fee and it is suitable when participants appointed *takaful* operators as their agent in managing their funds and operations. *Mudarabah* on other hands is suitable for investment purpose where the returns from the investment will be shared between contracting parties. Respondent G stressed that *Shari'ah* and operational issues in 'pure *wakalah'* and 'pure *mudarabah'* concepts have driven *takaful* operators to re-modified these models into model which is known as hybrid model. This hybrid model offers flexibility to *takaful* operators to offer more sophisticated *takaful* products in the market.

Respondent B mentioned that history has shown that Malaysian *takaful* operators began their operation in 1980's using *mudarabah* concept. From the basis of *mudarabah* they explore the feasibility and marketability of *takaful* product based on *mudarabah*. At the same time, various issues regarding the suitability of *mudarabah* have been debated and questioned by many Muslim jurists. Then they explored other models, such as *wakalah* and hybrid, in order to find the most suit contract to be applied in *takaful*. The continuous and never-ending efforts by *takaful* operators contribute to the diversity in *takaful* and to develop models that are competitive with conventional insurance models.

Respondent C stressed that *wakalah* is preferable among *takaful* operators compare to *mudarabah* due to less *Shari'ah* issue and cost advantages. This is supported by Respondent D and

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(Thousand Oaks, CA, Sage: 2000); W. L. Neuman, *Social Research Methods: Qualitative and Quantitative Approaches,* 5/e, (Boston, MA, Allyn & Bacon 2003).

Respondent F which highlight through *wakalah* contract, *takaful* operators able to anticipate their operational costs efficiently using fixed *wakalah* fees. As for current *takaful* business model, majority respondents agreed that hybrid model is the most suitable contract as for Malaysian *takaful* market. Hybrid model is introduced to the market to cover the weaknesses of *wakalah* and *mudarabah* not only in operational but also in *Shari'ah* point of view. Respondent G argued that *wakalah* or *mudarabah* separately is not appropriate to be implemented in the whole process of *takaful* from the assessment of customers' risk profile until payment of compensation. Therefore, *takaful* operators propose for hybrid model where *wakalah* is being applied in underwriting process which related to risk and compensation management and *mudarabah* is implemented in the investment management.

4.2 Expert Views on Current Issues in Takaful Models

Respondent A and Respondent F stressed on the weaknesses of the current *takaful* models where they seem to give priority to serve the interest of shareholders rather than fulfilling the interest of participants. For instance, the issues on ownership in underwriting surplus and return in investment account for rise due to the conflict between shareholders and participants where both argue that they entitled for the returns. The conflict also occurred in second layer of *takaful* charge as highlighted by Respondent E where *takaful* operators charge double fee especially in the *mudarabah* model. The argument whether *takaful* operators are allowed to practice "*mudarib yudarib*" (another *mudarabah*) needs to be addressed by the *Shari'ah* scholars and the regulators. All these issues indicate the profit motive approach in business *takaful* models rather than mutuality and *ta`awuni* concepts as being promoted in *takaful*. This then can be justified in the concerns as expressed by Respondent A and Respondent F. They opined that when too much focus is given to profit motive will jeopardized the basis of *takaful*. The tendency of losing the spirit of *ta`awuni* and cooperative in the existing models is driven by the worldview of current *takaful* operators which focus on this *tijari* model. The same opinion also been addressed by Respondent B where current *takaful* models seem to depend on *tijari* model and not on *ta`awuni* model. This will reflect their approach in *takaful* management and the current *takaful* structure seem to be more risk transfer concept rather than risk sharing concept where the risks have been transferred and not being shared between contracting parties.

Issues in legal have been highlighted by Respondent A and Respondent C where current *takaful* models are encumbered by many rules and regulations such as capital adequacy, deposit insurance, paid up capital and others requirements. The burden of fulfilling these requirements are borne by management and shareholders where in some cases the shareholders have to inject capital in the business and this will affect the pricing of *takaful* and also the benefits received by *takaful* participants. For *takaful* operators, ensuring the CAR is more important than surplus distribution because they have to make sure than their capital is large enough to cover their future financial obligation.

Respondent B and Respondent E highlighted the important of handling *Shari'ah* issues in current *takaful* models. Issues such as in *wakalah* fee, *tabbaru'* issue, ownership of return and underwriting surplus issues need to be addressed properly. In order to develop competitive *takaful* products, *takaful* operators have to make sure methods and models that have been used are globally accepted. Even though *Shari'ah* issues are of prime important in constructing *takaful* models for *takaful* operators, Respondent E, Respondent F and Respondent G argued that *Shari'ah* issues do not have a high impact on the perception and trust of the *takaful* participants. They opined that participants are not aware of *takaful* models and most of them focus on the benefits and compensation they receive from *takaful* plans. *Shari'ah* issues, which do not involve in any *Shari'ah* compliancy matter or decision that rules *takaful* into non-*Shari'ah* compliance, will give no impact on participant trust.

5.0 Conclusion

As mentioned at the beginning of the article, this study aimed to analyze how these models contribute to the cooperative and mutual spirit of *takaful* from the experts' point of views. Hence, this paper analyses the practices of existing *takaful* models and it found that existing *takaful* models inclined towards more business-oriented to fulfill the expectation of shareholders.

Various issues in existing practices as mentioned by the experts such as *wakalah* fee, *tabbaru'* issue, ownership of return and underwriting surplus issues were among the issues that lessened the spirit of mutuality in *takaful*.

Hence, by limiting, if not ignoring, the mutuality concept embedded in existing *takaful* models, they have departed from its original form, where the mutuality and the cooperative concepts are the indispensable ingredients of *takaful*. Consequently, our findings have established that there is a need to have more robust mutual *takaful* concept, in order to balance existing business-oriented models.

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