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GROWTH OF ISLAMIC INSURANCE (*TAKAFUL*) IN MALAYSIA: A MODEL FOR THE REGION?

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Takaful, like conventional insurance, involves the allocation and spreading of risk, and is becoming an increasingly important part of our professional and personal lives. This article seeks to set the stage by clarifying the position of *takaful* within the Malaysian secular common law system with respect to the applicability of Syariah law. In doing so, a comparative analysis will be made of the situation in other Islamic jurisdictions like the Middle East, Pakistan and Indonesia. The latter part of the article will then examine the legal framework regulating *takaful* in Malaysia, with the aim of suggesting much needed reform, especially with respect to the *Takaful Act 1984*, so as to support and further boost the growth of *takaful* in Malaysia, in line with the Malaysian government's aspirations of establishing Malaysia as an international Islamic financial centre.

I. INTRODUCTION

Insurance has long been an important part of modern living, with non-marine insurance being broadly categorised into life and general insurance. Today, however, with the increased financial sophistication of consumers, complex insurance plans have been invented with more investment-linked products, thus blurring the traditional borders within the financial services industry. Along with this sophistication has come the advent of "alternative distribution channels such as bankassurance, direct marketing, and internet insurance and strategic alliances with other financial and non-financial entities so as to complement the existing traditional agency system."[1]

As far as Malaysia is concerned, conventional insurance exists side by side with its more recent counterpart, *takaful*, which is the Islamic system of mutual insurance built on principles of Syariah or Islamic law. *Takaful*, which has primarily grown on religious grounds in complementing the advent of Islamic banking, has over the past decade shown its potential as an innovative financial instrument.

This article focuses on the concept of *takaful* and its position within the Malaysian secular common law system, with a comparison being made to the situation in other Islamic jurisdictions, in an attempt to evaluate its viability as an alternative to conventional insurance in Malaysia and the region.

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1 Bank Negara Malaysia, *The Central Bank and the Financial System in Malaysia—A Decade of Change 1989-1999*, (Kuala Lumpur: Bank Negara Malaysia, 1999) at 479 [*The Central Bank*].

II. The Insurance Industry in Malaysia

In Malaysia, the insurance industry has been regulated by Bank Negara Malaysia (the Central Bank) since 1 May 1988. Prior to that, the Ministry of Finance regulated the industry. The regulation of the insurance industry by the Central Bank involves policy development, administration and enforcement of the *Insurance Act 1996* governing the insurance industry, carrying out the actuarial function, supervision of insurance licensees, consumer education and complaints handling.

As at the end of December 2006, the total number of licensees in the industry stood at 119, comprising 42 direct insurers, 7 professional reinsurers, 34 insurance brokers, and 36 adjusters.[2] These licensees are in turn required by the *Insurance Act 1996* to be members of one of the statutory insurance associations in Malaysia, namely the General Insurance Association of Malaysia (PIAM), the Life Insurance Association of Malaysia (LIAM), the Insurance Brokers Association of Malaysia (IBAM), or the Association of Malaysian Loss Adjusters (AMLA).

Insurance disputes, on the other hand, can either be referred to the civil courts, the Customer Services Bureau of the Central Bank, or the Financial Mediation Bureau (which was formerly known as the Insurance Mediation Bureau from 1991-2005).[3]

III. The Concept of *Takaful*

Insurance in Islam is essentially a concept of mutual help. It is said that the operation of insurance was established in the Arab tribal custom of blood money or *diyah*, where the victim would be compensated by those members of the community whose action had resulted in the loss of life or impairment of the victim. The principle of compensation and group responsibility was accepted and practised by the Muslims of Mecca (*Muhajirin*) and Medina (*Ansar*), laying the foundation for mutual insurance over 1400 years ago.

In Asia, the practice of insurance was first established in the early second century of the Islamic era, during the time when Muslim Arabs started to expand their trade to India, the Malay Archipelago and other Asian countries. Owing to the long distance involved, the dangers inherent in the journey, and the losses arising from mishaps and misfortunes or robberies, the Muslim Arab traders got together and mutually agreed to contribute to a fund that would be used to compensate anyone in the group who suffered losses.

The concept of insurance where common resources are pooled in order to help the needy therefore does not contradict the teachings of Islam, which in any event propagates solidarity, mutual help and cooperation among members of the community. Muslim scholars, however, differ in their views on the permissibility (*halal*) or prohibition (*haram*) of insurance. Some accept insurance in its traditional form as

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2 These figures were obtained from the *Insurance Annual Report 2005* (Kuala Lumpur: Bank Negara Malaysia, 2006) at 2.

3 The Financial Mediation Bureau is the preferred choice amongst complainants according to the Financial Mediation Bureau's *Annual Report* for 2005, with about 1,664 complaints being referred to it involving both insurance and *takaful* matters. In fact, for 2006, there has only been 1 reported insurance case in the courts, namely the Court of Appeal decision of *Leong Kum Whay v. QBE Insurance (M) Sdn. Bhd.* [2006] 1 C.L.J. 1.

the necessary development of modern Islamic concepts, whereas the more conservative argue for its prohibition owing to the presence of the prohibited elements of uncertainty of outcome (*gharar*), gambling (*maisir*) and interest (*riba*).[4]

The business of conventional insurance is based on a contract of buying and selling, where one party sells protection and the other party buys the service at a certain cost. It contains the elements of *Al-gharar* (uncertainties in the operation of the insurance contract), *Al-maisir* (gambling as a consequence of the presence of uncertainty), and *Al-riba* (interest), which contravene the rules of Syariah.[5] *Gharar* arises due to the uncertainty of the subject matter of the contract, for example, the occurrence of the misfortune and the source and amount of compensation. Consequently, obtaining compensation or proceeds from a financial transaction that contains *gharar* will lead to the practice of *maisir* or gambling according to Islam. Islam also prohibits dealing in *riba* or interest. This same prohibition is the fundamental reason for the initiation of interest-free or Islamic banking,[6] which in turn is often related to a revival of Islam and a desire of Muslims to live all aspects of their lives in accordance with the teachings of Islam.[7]

Apart from this, those who purchase *takaful* for religious reasons (and not for profits alone) view conventional insurance as having evolved into a profit-generating venture which violates the spirit of Islamic teachings. Conventional insurance also cannot ensure Islamic policyholders that the returns paid out in claims settlement come from acceptable means, *i.e*. from stocks invested in companies producing or dealing in *halal* (as opposed to *haram*) goods or services.[8]

Therefore, the operation of an insurance system conforming to the rules and requirements of Syariah must not be based on a buy-and-sell contract. Instead, the subject-matter of the contract must be definite, clear and transparent so that all parties to the contract are aware of it. A system of Islamic insurance incorporating the virtues of cooperation, mutuality and shared responsibility in line with Syariah was needed. Hence, *takaful* was established as the Islamic alternative to conventional insurance.

Takaful is essentially an agreement between a group of participants to jointly guarantee themselves against any loss or damage that may befall them as defined. Each member of the group contributes a premium to the *takaful* fund, with the amount of contribution corresponding with the extent of the risk involved. In the event that a participant suffers a loss due to a defined mishap, that participant will receive a sum of money from the fund to help mitigate the loss. The intention of *takaful* is to pay

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4 Ramin Cooper Maysami & John Joseph Williams, "Evidence on the Relationship between Takaful Insurance and Fundamental Perception of Islamic Principles" [2006] 2 Applied Financial Economics Letters 229 at 229-230.

5 *The Central Bank*, *supra* note 1 at 256.

6 A.L.M. Abdul Gafoor, "Islamic Banking," online: Islamic Banking & Finance <http://users.bart.nl/~abdul/chap4.html>; accessed on 26 November 2006.

7 Aly Khorshid, *Islamic Insurance: A Modern Approach to Islamic Banking,* (London: Routledge Curzon, 2004) at 113. In fact, in the Malaysian context, socio-cultural research findings support the fact that ethnic Malays (who form the Muslim majority population making up more than 60%) place a great deal of importance on the fulfillment of their religious obligations and do not separate the teachings of Islam from all aspects of life: Asma Abdullah & Lrong Lim, "Cultural Dimensions of Anglos, Australians and Malaysians" (2001) 36:2 Malaysian Management Review 1 at 7.

8 Au Pui Khuan & Ramin Cooper Maysami, "Islamic Insurance in Malaysia: A Successful Model in Operation" (1998) 6:3 Int'l. Ins. L. Rev. 79.

for a defined loss from a defined fund. It is therefore a scheme where the participants themselves are the insureds as well as the insurers.

IV. The *Takaful* Industry in Malaysia

In June 1972, the National Fatwa Committee declared that the concept of conventional insurance contravened the rules of Syariah. In 1982, the Task Force to Study the Establishment of an Islamic Insurance Company in Malaysia was formed to look into the possibility of launching Islamic insurance as a complement to Islamic banking. Following the recommendations of the Task Force, the Malaysian Parliament enacted the *Takaful Act 1984*, thus giving birth to the Takaful Scheme in Malaysia.

In conformity with Syariah, the operation of *takaful* in Malaysia is confined within the ambit of *Tijari*, or the commercial or private sector, based on the Islamic commercial profit-sharing principle of *Al-mudharabah*. *Al-mudharabah* is recognised as the commercial profit-sharing contract between the providers of funds for a business venture (participants) and the entrepreneur who actually conducts the business.[9] The principle of the *Al-mudharabah* contract has been successfully modified and developed into the Malaysian model, where the participant of a *takaful* product is entitled under the contract to enjoy a return on the contribution or premium paid in consideration for participating in the product. This is in contrast to the *Al-wakalah* principle, which is based on the idea that the operator, acting as an agent of the participants, can charge its management expenses on the *takaful* contributions or premium paid.

The operation of *takaful* in Malaysia is regulated by the *Takaful Act 1984*, section 54 of which entrusts the Central Bank with the responsibility of administering the *Act*, whereby the Governor of the Bank is also the Director General of Takaful.[10] In 2002, the Malaysian Takaful Association was formed as an association for *takaful* operators to improve industry self-regulation through uniformity in market practice and to promote a higher level of co-operation amongst the operators in developing the *takaful* industry.

Takaful is defined in section 2 of the *Act* as a scheme based on brotherhood, solidarity and mutual assistance whereby the participants mutually agree to contribute to provide for mutual financial aid and assistance in case of need. The *Act* also classifies *takaful* business into the family solidarity business (defined as *takaful* for the benefit of the individual and his family) and general business (defined as all *takaful* business that is not family solidarity business).[11] In the terminology of conventional insurance, family solidarity business refers to life insurance while general business is equivalent to general insurance.

Family *takaful* is similar to an endowment policy. A participant decides on the maturity period, the amount of annual contribution (provided it is above the minimum amount set by the company), and the frequency of contributions. The money goes into two different accounts, namely the Participants' Account (PA) (a savings and investment account) and the Participants' Special Account (PSA) (which is for

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9 *The Central Bank*, *supra* note 1 at 257.

10 This makes the Central Bank responsible for administering both the *Insurance Act 1996* and *Takaful Act 1984*, respectively.

11 S. 3(1)(a) of the *Takaful Act 1984*.

contributions made for the purpose of *Tabarru* or donation). Money from both accounts is invested in accordance with Islamic principles.

General *takaful* protects participants against losses from personal accidents and loss or destruction of property. The contract specifies the amount of contribution that the participant has to make. All contributions are paid into the general *takaful* fund. Part of the fund is used to cover the expenses while the rest of the fund is invested like in family *takaful*. Profits in the fund are then shared between the company and the participants.

The registration of *takaful* operators is covered in section 8 of the *Takaful Act 1984*. Section 8(5) states that the applicant must satisfy the Director General of Takaful that the aims and operations of the *takaful* business will be in accordance with Syariah, and that the Articles of Association provides for the setting up of a Syariah Supervisory Council. As at February 2008, there were 8 registered *takaful* operators in the country, namely Syarikat Takaful Malaysia Berhad, CIMB Aviva Takaful Bhd., Hong Leong Tokio Marine Takaful Bhd., MAA Takaful Berhad, Takaful Ikhlas Sdn. Bhd., Prudential BSN Takaful Bhd., HSBC Amanah Takaful (Malaysia) Sdn. Bhd., and Etiqa Takaful Bhd. In addition to this, the Central Bank in September 2006 approved the licenses of 2 additional re-*takaful* companies, namely Munich Re and MNRB Holding Bhd.,[12] in a bid to further strengthen the institutional infrastructure of the *takaful* industry as well as synergize the financial sector.

The role of *takaful* within the Malaysian secular common law system is clearly delineated by the Malaysian Federal Constitution. *Takaful*, albeit being Islamic insurance, is considered to be a part of mainstream mercantile law, and hence a part of civil law and subject to the civil court structure of Malaysia. As such, the Federal Parliament has jurisdiction to legislate over it (as it has done *via* the *Takaful Act 1984*), as opposed to being regulated by Syariah law and the Syariah courts. This is apparent from the combined effect of Articles 73, 74, 75, 121(1), 121(1A), and the 9th Schedule of the *Federal Constitution of Malaysia*,[13] and is in line with Malaysia being a moderate Islamic country, with Syariah being confined to personal and inheritance matters.

For that matter, most of the nations in the region where *takaful* is offered on a fairly large scale (for example, Bahrain, Pakistan, Egypt, Indonesia, Singapore and Brunei) also treat it as being a part of mainstream mercantile law (which in turn is largely based on their respective common law and civil law roots).[14] Only Saudi Arabia and Sudan take the conservative approach of treating *takaful* as being a part of Syariah.

V. The *Takaful* Industry in the Region

In fact, until recently, Malaysia was the only country that had a special piece of legislation (the *Takaful Act 1984*) to licence and supervise *takaful* operations, and

[12] Bank Negara Malaysia, Press Statement, "Measures to further Strengthen the Institutional Infrastructure of the Takaful Industry" (18 September 2006).

[13] See Mohamed Ismail Mohamed Sharif, "The Legislative Jurisdiction of the Federal Parliament in matters involving Islamic law" [2005] 3 M.L.J. cv.

[14] Pakistan, Singapore, Brunei, Egypt and Malaysia adhere to common law, Indonesia mainly Dutch civil law, and Bahrain a combination of common law and French civil law.

was one of the first to adopt a *takaful* system parallel to its conventional counterpart. In 2005, however, Pakistan enacted its *Takaful Rules*, which, like Malaysia, stands separate from its *Insurance Ordinance 2000*. Where they differ, however, is that *takaful* operators in Pakistan[15] have to comply with both the *Takaful Rules* and *Insurance Ordinance*, with the latter (which has extensive provisions for insurance market conduct, including provisions for utmost good faith, non-disclosure and misrepresentation) filling in any gaps left by the former. This places Pakistan, at least in terms of *takaful* regulation, amongst the forerunners in the industry.

On the other hand, as this article explains below,[16] Malaysian legislation regulating conventional insurance and *takaful* (the *Insurance Act 1996* and the *Takaful Act 1984* respectively) provides for mutually exclusive jurisdictions, with the latter lacking comprehensive scope.

Bahrain, which is also amongst the *takaful* elite, has in 2005 enacted its Central Bank of Bahrain's (formerly known as Bahrain Monetary Agency) *Rulebook Volume 3*. This is separated into modules regulating both conventional insurance and *takaful*, and extensively covers many areas including business conduct, intermediaries, and enforcement.

Singapore,[17] on the other hand, began offering *takaful* in order to capture the newly affluent Singaporean Muslim market looking for profitable investment opportunities and insurance protection which are consistent with their religious beliefs.[18] As it currently stands, the Monetary Authority of Singapore regulates both the conventional insurance and *takaful* industries *via* the *Insurance Act*.[19] There is no separate piece of legislation or regulation governing *takaful* in Singapore;[20] the Monetary Authority of Singapore merely refines existing regulations on a case-by-case basis to accommodate Islamic finance issues, leaving the compliance of *takaful* with Syariah mainly to individual company policy.[21]

Egypt is largely based on the common law system with Syariah governing only inheritance and personal matters, much like Malaysia. The difference however, is that it has a very small number of *takaful* operators and has no separate *takaful* regulation to govern the same. Like Singapore, the conventional insurance and *takaful* industries are regulated by the same legislation, *Act No. 10 of the Supervision and Control of Insurance in Egypt* and the *Executive Regulations of 1981*, and are monitored by the Egyptian Supervisory Authority under the auspices of the Ministry of Investment.

As far as Indonesia and Brunei are concerned, the conventional insurance and *takaful* industries in each of these two countries are regulated by a single piece of legislation, with *takaful* still in its early stages of development.

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15 The number of operators as at February 2006 stands at only 1, namely the Pak Kuwait Takaful Company Limited (doing general *takaful* business), as opposed to 55 conventional insurance companies.

16 See Part VIII below.

17 This is the only non-Muslim country examined herein where *takaful* is actively promoted.

18 Au & Maysami, *supra* note 8 at 84.

19 (Cap. 142, Rev. Ed. Sing. 2002).

20 See Monetary Authority of Singapore, *Annual Report 2005/2006* (Singapore: Monetary Authority of Singapore, 2006).

21 This might be in part because of the demand for *takaful* in Singapore being either 'unknown or not sufficiently known for the insurance companies themselves to initiate something.': Dr. Richard Hu, former Minister for Finance of Singapore in *Windows of Opportunities for Islamic Financing,* Karayawan, Volume 3.

In more conservative Islamic nations such as Saudi Arabia and Sudan, *takaful* is regulated by Syariah. Sudan currently does not appear to have specific insurance or *takaful* legislation and merely requires Syariah compliance through its Syariah Supervisory Board. Saudi Arabia passed the *Cooperative Insurance Companies Control Law*[22] in 2003, and officially began to allow foreign and local insurance companies to establish and register both insurance and *takaful* operators in the country, provided their respective Articles of Association make provisions for Syariah compliance. The Saudi Arabia Monetary Agency was created as the governing authority of both industries.

VI. The Relevance of Insurance to *Takaful*

Since *takaful* and insurance are essentially part of mainstream mercantile law in Malaysia, with the English common law forming the basis for both, a comparison can be drawn between conventional insurance principles and *takaful*. Furthermore, as one author correctly points out:

> Regulations adopted in this respect will obviously vary from one system to another but not so fundamentally as to justify the characterization of a system as 'Islamic' or 'non Islamic,' for the basic mechanisms of insurance are universal, as is the concern about limiting unfair advantages of the insurer.[23]

Also, in so far as *takaful* regulation is concerned, Malaysia is no longer seen as the leader, with countries like Pakistan and Bahrain having caught up with fairly comprehensive regulations as recently as 2005. Malaysia is however still seen as being amongst the *takaful* elite, in view of the relatively large number of *takaful* and re-*takaful* operators it houses as well as the sustained growth of *takaful* sales within the country.

The *takaful* industry in Malaysia has enjoyed a healthy growth at an average of 25% for the past 5 years. As at the end of 2005, *takaful* contributions formed 5.4% of the total insurance sector, with its distribution channels being primarily direct marketing (61%), and *bancatakaful* (20.4%),[24] with the rest through agents and brokers.[25] The high growth rate in the Malaysian *takaful* industry has been fuelled mainly by the family *takaful* sector, with new business netting a growth of 20.2% and investment-linked family *takaful* plans experiencing more than a 7-fold increase in 2005, owing to more Syariah compliant financial instruments being issued.

In view of this positive outlook, as well as the establishment of the Malaysian International Financial Centre (MIFC),[26] matters such as suitable and sustainable product development and marketing[27] (which are beyond the purview of this article)

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22 Royal Decree No. M/32.

23 Khorshid, *supra* note 7 at 160.

24 This is owing to its wide distribution network and customer base, with most of the local banks in Malaysia having an insurance arm as well as an Islamic banking branch.

25 Bank Negara Malaysia, *Takaful Annual Report 2005* (Kuala Lumpur: Bank Negara Malaysia, 2006) at B2-3.

26 International Islamic banks and *takaful* operators will enjoy a 10-year tax exemption under the *Income Tax Act 1967* with effect from the Year of Assessment 2007.

27 See Maysami & Williams, *supra* note 4 at 232: an interesting article examining these issues (albeit more particularly with respect to neighbouring Singapore) seems to indicate that Muslims who are supposedly

and substantive legal issues concerning *takaful* regulation need to be addressed, in order to bring Malaysia back at the forefront of *takaful* development. It is especially crucial that issues of utmost good faith be addressed, as seen from the statistics provided by the *Takaful Annual Reports* and the Insurance/Financial Mediation Bureau's *Annual Reports*, which between 2000 to 2005 consistently showed that a large proportion of public complaints over *takaful* (and insurance for that matter) stem from alleged breaches of this fundamental duty.

For example, in 2005, of the 42 case examples analysed and reproduced in the Financial Mediation Bureau's *Annual Report*, 35 related to issues of utmost good faith. Approximately 68% of the complaints handled in 2005 with respect to general *takaful* and 82% as to family *takaful* concerned utmost good faith in one form or another, as adherence to this duty spans from the pre-contractual stage right through to claims settlement. These statistics are a valuable indicator of the current state of affairs, as most cases on *takaful* (and insurance) in Malaysia are filed with the Bureau as opposed to the courts.

In response to this, however, there has been no substantive legislative change made since the enactment of the *Takaful Act 1984*, although the government has injected some improvement with respect to the infrastructure supporting the industry, by way of improving the grievance redress mechanisms and introducing the Consumer Education Programme.[28] These measures, albeit timely and necessary, are long-term measures which need to be supported by more immediate legislative amendment according clearer and fairer rights and responsibilities to the parties concerned. It is in this context that the rest of this article will evaluate the adequacy of *takaful* regulation in Malaysia.

VII. The Concept of Good Faith in Conventional Insurance

The duty of utmost good faith forms the essence of insurance law, as insurance contracts are known as contracts *uberrimae fidei* or contracts of utmost good faith. Because of the unique speculative nature of insurance contracts, both insurers and insureds are required to exercise the utmost of good faith when dealing with each other, failing which the innocent party is entitled to avoid the contract *ab initio*. The duty of utmost good faith in insurance contracts is a broad positive duty imposed on both parties to the contract, essentially requiring them to act honestly towards each other without any deception or underhandedness. This principle of good faith in non-marine insurance was first introduced at common law in the case of *Carter v. Boehm*[29] where Lord Mansfield stated:

> Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the under-writer trusts to his representation, and proceeds upon

the target recipients of *takaful* products, remain largely unaware of the existence of these services and more so, that Muslims with conservative values seem to be less aware of *takaful* as compared with Muslims with liberal values.

[28] This is a 10-year programme launched in 2003 to educate consumers (of *takaful* and insurance) of their contractual rights and responsibilities, so as to be able to make well-informed decisions, both in product selection as well as meeting their legal and contractual obligations.

[29] (1766) 3 Burr. 1905, 97 E.R. 1162.

> confidence that he does not keep back any circumstance in his knowledge, to mislead the under-writer into a belief that the circumstance does not exist, and to induce him to estimate the risqué, as if it did not exist.
>
> The keeping back such circumstance is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without any fraudulent intention; yet still the under-writer is deceived, and the policy is void; because the risqué run is really different from the risqué understood and intended to be run, at the time of the agreement … Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary.[30]

This principle was later embodied in section 17 of the *Marine Insurance Act 1906*[31] of the United Kingdom, which provides:

> A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party.

It has long been accepted in the United Kingdom that the *Marine Insurance Act 1906* (essentially a codification of the common law) applies also to non-marine insurance contracts, thus seemingly pre-empting the need for a separate piece of legislation to govern the same.[32]

Its applicability to Malaysia, however, is by virtue of section 5(1) of the *Civil Law Act 1956* (Malaysia),[33] which imports into the states of West Malaysia (other than Malacca and Penang) insurance and mercantile law administered in England in the like case as at 7 April 1956. This has been endorsed in decisions such as *Leong Brothers Industries Sdn. Bhd. v. Jerneh Insurance Corporation Sdn. Bhd.*,[34] owing to the lack of a parallel statute to the effect in Malaysia. As for the states of Penang, Malacca, Sabah and Sarawak, section 5(2) provides for the application of insurance and mercantile law administered in England in the like case at the corresponding period.

The position with respect to the application of the *Marine Insurance Act 1906* and the common law to marine insurance cases in Malaysia is clear and unaltered, as there is no corresponding statute to the effect in Malaysia. With respect to non-marine insurance cases in Malaysia, it would appear that the provisions of the *Marine Insurance Act 1906* and common law would apply, save where they are inconsistent with the provisions of the *Insurance Act 1996*, in which case the latter would prevail.

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30 *Ibid.* at 1909-1910.

31 (U.K.), 6 Edw. VII, c. 41.

32 This is apparent in Steyn J.'s dicta in *Banque Keyser Ullmann S.A. v. Skandia (U.K.) Insurance Co. Ltd.* [1987] 1 Lloyd's Rep. 69 at 93 where his Lordship said: "[T]he Act was a codification of the common law, and it is inconceivable that the common law regarded marine insurers as bound by a duty of utmost good faith but not other insurers."

33 S. 5(1) states:

> In all matters pertaining to the law of marine insurance, average, life and fire insurance and mercantile law generally, to be decided in the States of West Malaysia other than Malacca and Penang, the law to be administered shall be the same as would be administered in England in the like case at the date of the coming into force of the Act.

34 [1991] 1 M.L.J. 102.

The continued application of the *Marine Insurance Act 1906* and common law to non-marine insurance in Malaysia is evident from the fact that the general principle of utmost good faith laid down in section 17 of the *Marine Insurance Act 1906* has long been accepted as the foundation of insurance law in Malaysia, although there surprisingly appears to be no corresponding provision in the *Insurance Act 1996* or the *Takaful Act 1984* to that effect.[35]

A. *Scope of the Duty of Utmost Good Faith*

The duty of utmost good faith spans from the pre-contractual negotiations stage, through the subsistence of the insurance contract up until the claims settlement stage. However, the scope of the duty may well vary at each stage of the contract.[36]

As far as Malaysia is concerned, section 150(1) of the *Insurance Act 1996* lays out the insured's pre-contractual duty of disclosure for conventional insurance, which forms a part of the duty of utmost good faith. Section 150(1) provides as follows:

> Before a contract of insurance is entered into, a proposer shall disclose to the licensed insurer a matter that—
> (a) he knows to be relevant to the decision of the licensed insurer on whether to accept the risk or not and the rates and terms to be applied; or
> (b) a reasonable person in the circumstances could be expected to know to be relevant.

Prior to the enactment of section 150, the pre-contractual duty of disclosure in Malaysia was based on sections 18(1) and (2) of the *Marine Insurance Act 1906*, which essentially provides as follows:

> Subject to the provisions of this section, the assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract.

It should be noted at this juncture that section 150(1) of the *Insurance Act 1996* (largely based on section 21 of the *Insurance Contracts Act 1984* (Cth.) of Australia) is a step in the right direction taken by the Malaysian legislature with respect to conventional insurance, as it imposes a fairer burden of disclosure on the insured based on information which 'a reasonable person in the circumstances' ought to know, as opposed to the more onerous English requirement of that which a 'prudent insurer' would like to know. It fails, however, to address the remedy available in the event of such non-disclosure.

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[35] It is submitted that this seems to be more of an oversight rather than a deliberate omission, as Malaysian cases have repeatedly paid homage to the principle of good faith in both marine and non-marine insurance contracts (*takaful* included).

[36] This is clear from the words of Legatt L.J. in *Manifest Shipping & Co. Ltd. v. Uni-Polaris Insurance Co. Ltd.* [1997] 1 Lloyd's Rep. 360 at 370:

> It was common ground between assured and underwriters that the duty of utmost good faith continues to subsist after the making of the contract. There is less common ground as to the content of the duty or as to the remedy for breach of the duty.

B. *Reciprocity in Good Faith*

Sections 18(1) and (2) of the *Marine Insurance Act 1906* and section 150(1) of the *Insurance Act 1996* only make specific mention of the insured's pre-contractual duty of disclosure and not other aspects of the duty of utmost good faith, like that which is owed by the insurer.

The English courts in *Banque Keyser Ullmann S.A. v. Skandia (U.K.) Insurance Co. Ltd.*[37] explicitly held that an insurer was under a similar duty as the insured to exercise utmost good faith in making disclosure of facts material to the insurance contract. This view of the reciprocity of the duty of utmost good faith with respect to both insurer and insured was later endorsed by the Court of Appeal in *Banque Financiere v. Westgate Insurance Co. Ltd.*[38] and in *Banque Financiere v. Skandia (U.K.) Insurance Co. Ltd.*,[39] where it was further stressed that the duty extends to the insurer as well as to the insured.

Incidentally, the reciprocal nature of the duty of good faith may seem fair on the surface. However, the problem arises where an insurer does not act in the utmost good faith and the insured is only entitled to rescission of the contract and a return of premiums paid, without any right to damages, especially if the insured has suffered a substantial loss as a result of the insurer's breach.

C. *Insurer's Duty of Utmost Good Faith*

Although section 17 of the *Marine Insurance Act 1906* points out that the duty of utmost good faith must be observed by both parties to an insurance contract, legislation is unclear as to the aspects of the insurer's duty—unlike the insured, who has to abide by the pre-contractual duties clearly set out in the *Marine Insurance Act 1906* and *Insurance Act 1996*.[40]

In Malaysia, the insurer is required to provide a clear warning, in conventional insurance proposal forms to prospective insureds, of the consequences of pre-contractual non-disclosure. This is contained in section 149(4) of the *Insurance Act 1996* which provides:

> A proposal form and, where no proposal form is used, a request for particulars by the licensed insurer shall prominently display a warning that if a proposer does not fully and faithfully give the facts as he knows them or ought to know them, the policy may be invalidated.

Such a statutory warning would be an example of compliance with the duty of utmost good faith on the part of the insurer and is indeed a positive step taken by the legislature. Its drawback, however, is that the *Insurance Act 1996* does not provide for a remedy in the event of a breach of or non-compliance with section 149(4) by insurers, unlike the position in Australia for instance, where section 22(3) of the *Insurance Contracts Act 1984* (Cth.) clearly provides that non-compliance with

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37 [1987] 1 Lloyd's Rep. 69.
38 [1988] 2 Lloyd's Rep. 513.
39 [1990] 2 Lloyd's Rep. 377 at 389.
40 Ss. 18(1) and (2) and S. 150(1) respectively.

section 22(1) (the Australian equivalent of section 149(4)) would result in the insurer not being entitled to exercise a right in respect of the proposer's failure to comply with the duty of disclosure, unless the failure was fraudulent.

Apart from section 149(4), however, the *Insurance Act 1996* currently does not explicitly address other aspects of the insurer's duty of utmost good faith owed to the insured. The *Act* is silent on the parties' obligation to exercise good faith in claims settlement, which would cover crucial aspects like delay, frequent contesting and rejection of claims without reasonable grounds, and unduly strict construction of policy terms to justify rejection of claims.

VIII. Scope of the *Takaful* Act 1984

As mentioned earlier, the *Takaful Act 1984* governs *takaful* operations in Malaysia. However, according to Nik Ramlah Mahmood,[41] the *Takaful Act 1984* is only regulatory in nature. It is not a statutory source of the substantive law relating to the Islamic scheme of mutual insurance as it has very few provisions on how the *takaful* scheme should be implemented. It mainly deals with the regulations with regard to the setting up and operation of a *takaful* business, rather than the application of Islamic principles in *takaful*. It provides the definition of *takaful*,[42] the requirement for establishing the Syariah Advisory Council at the Central Bank's end and Syariah Committees in each *takaful* operator's organisation[43] in order to ensure Syariah compliance, and the types of *takaful* business that a licensed operator may provide. The function of the Syariah Committees is supervisory, in that it is to advise the company on matters relating to Syariah. The *Takaful Act 1984* does not mention matters such as the status of the committees' advice, *i.e.* whether it is binding on the company.

Following a review of the *Takaful Act 1984* in 2003, section 53A was inserted, elevating the Syariah Advisory Council to the sole authority on Syariah matters pertaining to Islamic banking and finance. The Syariah Advisory Council will also serve as the reference point by the court or the mediator in resolving disputes that involve Syariah issues on Islamic banking and finance. To further strengthen the Syariah and legal infrastructure, the *Guidelines on the Governance of Syariah Committees* for Islamic financial institutions were issued in 2004 to streamline the functions and duties of the Syariah Committees of *takaful* operators and to strengthen their independence. The role of the Syariah Advisory Council was also enlarged and reinforced to ensure better Syariah governance. The application of the substantive principles of Islamic law to *takaful*, however, remains unclear because it is only implied in a few provisions of the *Takaful Act 1984*. To make matters worse, by virtue of section 67(2) of the *Takaful Act 1984*, the *Insurance Act 1996* also does not apply to *takaful*.[44]

In *takaful*, it is important to prove insurable interest,[45] especially for general *takaful*. This is not specified in the *Act* but was recommended by the Task Force

41 Nik Ramlah Mahmood, *Insurance Law in Malaysia* (Singapore: Butterworths, 1992) at 247.

42 S. 2 of the *Takaful Act 1984*.

43 S. 53A of the *Takaful Act 1984*.

44 This is unlike the situation in Pakistan for instance, where its *Takaful Rules 2005* clearly provide that any gap therein shall be filled by reference to the *Insurance Ordinance 2000*.

45 This requirement is also present in conventional insurance by virtue of S. 152 of the *Insurance Act 1996*.

set up in 1982 to study the establishment of the first Islamic insurance company in Malaysia, as it helps to ensure that adequate compensation is given.

As far as other important substantive provisions go, the *Takaful Act 1984* does not have any provisions governing the duty of disclosure. The *Takaful Act 1984* also does not have an explicit requirement for observance of the duty of utmost good faith. Nik Ramlah Mahmood postulated two explanations for this omission.[46] The first is that since *takaful* is a form of insurance, the *takaful* contract is an insurance contract. And, as insurance contracts are contracts *uberrimae fidei* or contracts of utmost good faith, the duty of utmost good faith would apply to *takaful* as well. The other possibility is to treat a *takaful* contract like any other ordinary contract, in which case it can only be avoided if there has been a positive act of fraud or misrepresentation. It is submitted that this is no longer in doubt, as utmost good faith is viewed as a principle central to *takaful*,[47] much like in conventional insurance.

That being the case, parties to the contract are required to act with utmost good faith towards each other or the contract will be void *ab initio* at the instance of the innocent party. The problems with this have been addressed earlier with respect to conventional insurance.[48] In the event one party to the contract breaches or fails to carry out the duty, the other party can avoid the contract. The contract can be rescinded and premiums refunded. Neither the *Takaful Act 1984* nor the *Insurance Act 1996* at present provides for damages as a remedy, and this is indeed a problem where the insured has experienced substantial losses.

Another disadvantage of this solution is that the application of this duty, where parties must disclose all material facts, may result in a party being punished for innocent non-disclosure, as there is currently no requirement for the existence of a causal connection between the non-disclosure and loss.[49] This is presumably against basic Islamic principles where fairness and justice are paramount.

The point of setting out in this article the shortcomings of the *Insurance Act 1996* and conventional insurance as it applies in Malaysia is to show that the existing substantive legal position with respect to *takaful* leaves even more to be desired than its conventional counterpart.

Not only is there no express provision for the duty of utmost good faith (to be observed from the proposal right up to the claims settlement stage) or for the availability of damages as a remedy for a breach thereof, the *Takaful Act 1984* even lacks some of the basic utmost good faith provisions which can be found in the *Insurance Act 1996*, like the pre-contractual duty of disclosure required of the insured[50] and the crucial warning in section 149(4) of the *Insurance Act 1996* on the effects of

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[46] Mahmood, *supra* note 41 at 250.

[47] This is apparent in the Central Bank's write-ups on *takaful* found in its Insuransinfo booklets made available at all banks, financial institutions and insurance companies in Malaysia.

[48] See *supra* Part VII.

[49] This, on the contrary, is a necessary requirement for avoidance of conventional insurance policies in other common law jurisdictions like Australia and New Zealand.

[50] S. 150(1) of the *Insurance Act 1996* provides:

Before a contract of insurance is entered into, a proposer shall disclose to the licensed insurer a matter that—

(a) he knows to be relevant to the decision of the licensed insurer on whether to accept the risk or not and the rates and terms to be applied; or

(b) a reasonable person in the circumstances could be expected to know to be relevant.

non-disclosure by the insured.[51] Moreover, since the *Insurance Act 1996* does not apply to *takaful* matters,[52] the likes of sections 149(4), 150 and 152[53] cannot be imported to fill the gap.

Having said this, it cannot be said that the *Takaful Act 1984* was intended as a purely regulatory piece of legislation either, as it does contain some important substantive provisions. Section 66 provides that the knowledge of and statement by an authorised agent is deemed to be that of the *takaful* operator, which is in tandem with section 151 of the *Insurance Act 1996* and is an important protection for the insured. Sections 27 and 28 go on to impose controls on proposal forms, certificates and brochures as well as any statements made by insurers or their agents which may be misleading or deceptive. Also, section 26 (along the lines of its conventional counterpart in section 147 of the *Insurance Act 1996*) provides that a misstatement of the age of the participant or insured in a family *takaful* policy does not warrant avoidance of the contract by the *takaful* operator. Unfortunately, it does not go on to provide for any proportionate adjustment of the sum insured plus bonuses so as to address the matter.

This therefore seems to substantiate the view that the *Takaful Act 1984* was indeed meant to be the sole legislation governing the regulatory as well as substantive aspects of *takaful* in the country. Poor drafting and major oversights have however left it looking like a purely regulatory tool.

As such, it is necessary for the position with respect to the substantive provisions of *takaful* to be legislated upon, either through an amendment to the existing *Takaful Act 1984* or the enactment of a new statute to replace the same. This would be an essential move in ensuring the continued growth and sustainability of *takaful* in the country. It is submitted that it would most likely take the form of the former, as in 2003 when the Central Bank called for a revamp of the *Takaful Act 1984* in line with the objectives of the Financial Sector Master Plan, but unfortunately only brought about more regulatory amendment or clarification, like enlarging and reinforcing the Syariah Advisory Council's position in section 53A.

Should the Malaysian Parliament deem fit to legislate upon these substantive provisions, it is submitted that substantive provisions in line with conventional insurance should be adopted, like that in Pakistan, Bahrain and Singapore, with improvements on the existing provisions in the *Insurance Act 1996* on issues of good faith, disclosure and remedies. To this end, the bold reforms seen in other common law jurisdictions like Australia could be looked to as a guide. This is particularly so since *takaful* would have to operate alongside conventional insurance in this country, and as such would be viewed by the insuring public as a more viable alternative if it was comparable to (rather than completely different from) the existing laws on conventional insurance, subject of course to the requirements of Syariah, with improvements based on concepts of fairness and justice.

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[51] S. 149(4) provides:

> A proposal form and, where no proposal form is used, a request for particulars by the licensed insurer shall prominently display a warning that if a proposer does not fully and faithfully give the facts as he knows them or ought to know them, the policy may be invalidated.

[52] See S. 67(2) of the *Takaful Act 1984*.

[53] This relates to the requirement of insurable interest.

A. *Proposed Reforms*

With respect to insurable interest, a provision along the lines of section 152(1) of the *Insurance Act 1996* could perhaps be adopted, providing as follows:

> A life policy insuring the life of anyone other than the person effecting the insurance, or the life of a person mentioned in subsection (2), shall be void unless the person effecting the insurance has an insurable interest in that life at the time the insurance is effected and the policy moneys payable, or where the policy moneys are payable in instalments, the discounted value of all future instalments under the life policy, shall not exceed the amount of that insurable interest at the time the event resulting in payment of policy moneys occurs.[54]

As for the duty of utmost good faith itself, something akin to section 13 of the *Insurance Contracts Act 1984* (Cth.) of Australia could be devised which provides:

> A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.

The significance of such a provision is that it makes the duty of utmost good faith an implied term of the insurance contract and does not restrict the remedy for a breach of it only to avoidance of the contract and a refund of premium paid.

In addition, a provision along the lines of section 14(1) could be adopted which states:

> If reliance by a party to a contract of insurance on a provision of the contract would be to fail to act with the utmost good faith, the party may not rely on the provision.

This would in turn require both parties to the insurance contract to abide by the duty of utmost good faith and where there is a failure to do so, the party in breach would be prevented from enforcing its rights otherwise arising under the contract.

As for the remedies available in the event of non-disclosure (and misrepresentation) by the insured, section 28(1) of the *Insurance Contracts Act 1984* (Cth.) could be looked to as a possible guide. This section requires as a prerequisite to remedy that the insurer must have been induced to enter into the contract as a result of the non-disclosure or misrepresentation; avoidance of the contract is an option only where the non-disclosure or misrepresentation was fraudulent (and even then with some allowance being given to a little bit of fraud).[55] Otherwise, the insurer is only

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[54] S. 152(2) could provide as follows:
A person shall be deemed to have insurable interest in relation to another person if that other person is—
(a) his spouse, child or ward being under the age of majority at the time the insurance is effected;
(b) his employee; or
(c) notwithstanding paragraph (a), a person on whom he is at the time the insurance is effected, wholly or partly dependent.

[55] *Insurance Manufacturers of Australia Pty. Ltd. v. Heron* [2005] V.S.C. 482; S. 31 goes so far as to give the court a discretion to disregard the insurer's avoidance if it "would be harsh and unfair not to do so" thereby allowing the insured recovery of the whole or part of the claim as it thinks "just and

entitled to reduce its liability in respect of a claim to the amount that would place the insurer in a position as if the non-disclosure or misrepresentation had not occurred.[56] In this way, "the insurer's remedy for non-fraudulent non-disclosure is made proportionate to the prejudice suffered by the insurer, as a result of the insured's breach of duty."[57]

With respect to the pre-contractual duty of disclosure, a provision similar to section 150(1) of the *Insurance Act 1996* could be incorporated,[58] which would place a fairer burden of disclosure on the insured based on information which a 'reasonable person in the circumstances' ought to know as opposed to the more onerous 'prudent insurer' test which is presumably currently applicable *via* section 18 of the *Marine Insurance Act 1906*. However, the factors listed below tend to indicate that the omission in the *Takaful Act 1984* with respect to this provision was not deliberate and that in all likelihood, measures along the lines of the *Insurance Act 1996* (as opposed to common law) would be taken when the need arises.

These factors include: an examination of the language used in the 'Insurance-info booklets' distributed to the insuring public in Malaysia by the Central Bank under its Consumer Education Programme launched on 29 August 2003; the albeit inappropriate use of section 28 of the *Takaful Act 1984* as the basis for a statutory warning of this pre-contractual duty and its purported implications; the Malaysian government's desire to promote *takaful* regionally; and the fact that the Insurance Mediation Bureau (now known as the Financial Mediation Bureau) has thus far been dealing with good faith and disclosure issues emerging from *takaful* in a manner similar to that of conventional insurance (although lacking legislative basis for it).

On the issue of pre-contractual disclosure, a statutory warning to be displayed on *takaful* proposal forms along the lines of section 149(4) of the *Insurance Act 1996* should be adopted, so as to overcome the present dubious situation where most *takaful* proposal forms in Malaysia display a statutory warning to proposers to disclose material facts or face avoidance of the policy, but erroneously refer to section 28 of the *Takaful Act 1984* as the statutory basis for it. In fact, an examination of this provision[59] clearly shows that it is intended to deter *takaful* agents and brokers from

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equitable" provided of course the insurer has not been prejudiced by the fraudulent non-disclosure or misrepresentation in question.

56 S. 28(3); see *Prime Form Cutting Pty Ltd. v. Balitca General Insurance Co. Ltd.* (1991) 6 A.N.Z. Ins. Cas. 61-028; *Fruehauf Finance Corporation Pty. Ltd. v. Zurich Australia Insurance Limited* (1990) 20 N.S.W.L.R. 359; which along with other cases establish that the remedy under S. 28(3) can include reducing the insurer's liability under the policy to nil (if the insurer can prove that it would not have entered into the contract at all but for the non-disclosure or misrepresentation) and reducing its liability for a claim to nil (if it can prove that it would have excluded the relevant claim from cover by way of an excess or exclusion under an alternative policy which it would have issued had there been a proper disclosure or if the additional premium which it would have charged would have exceeded the amount of the claim).

57 Fred Hawke, "The Innocents Abroad" (2006) 17 Insurance Law Journal 2 at 13.

58 Except that avoidance should not be the inevitable remedy for non-disclosure, unless there is fraud.

59 Section 28(1):

> Any person who, by any statement, promises or forecasts which he knows to be misleading, false, or deceptive, or by any fraudulent concealment of a material fact, or by the reckless making (fraudulently or otherwise) of any statement, promise or forecast which is misleading, false or deceptive, induces or attempts to induce another person to enter into or offer to enter into any contract of takaful *with an operator* shall be *guilty of an offence* and shall, on conviction, be liable to a fine not exceeding twenty thousand ringgit or to imprisonment for a term not exceeding one year or to both. [emphasis added]

acting unconscionably. Furthermore, it makes it an 'offence' to make misleading statements, promises or forecasts which induce persons to enter into *takaful* contracts with '*takaful* operators'. This, coupled with the consequence of avoidance of the *takaful* contract being nowhere in sight, is evidence that section 28 was not enacted nor meant as a statutory warning. The continued use of such a provision in a blatantly erroneous fashion without any retraction by the governing authorities is further proof of the urgent need to make a substantive review of the *Takaful Act 1984*.

Such a provision along the lines of section 149(4) of the *Insurance Act 1996* should, however, contain two improvements over the existing provision. First, a remedy in the event of breach or non-compliance by insurers should be provided for like in section 22(3) of the *Insurance Contracts Act 1984* (Cth.) (Australia), resulting in the insurer not being entitled to exercise a right in respect of the proposer's failure to comply with the duty of disclosure, unless it was fraudulent. Second, the reference to invalidation or avoidance of the policy[60] as a remedy in section 149(4) should be omitted, thereby making room for damages as a remedy.

To be more effective, the statutory warning should perhaps expressly stipulate that the proposer is under a positive duty to not only truthfully and accurately answer the questions posed in the proposal form, but also to provide any other information which he or she knows or which a reasonable person in the circumstances could be expected to know to be relevant to the insurer's decision on whether to accept the risk and the rates and terms to be applied. Such an expanded warning, coupled with the provision of some conspicuous space in the proposal form beneath the warning for proposers to volunteer information, would appear to be necessary to effectively draw the standard of the pre-contractual duty of disclosure (similar to section 150(1) of the *Insurance Act 1996*) to the proposers' attention. Otherwise, the widespread misconception that all the proposer needs to do is to answer the questions posed in proposal forms honestly and correctly[61] would only perpetuate, much to the insured's detriment.[62]

In addition, there should be an automatic provision to insureds of a copy of the proposal form filed with the insurer, which should also contain a prominent warning that the proposer should keep a record of all information supplied to the insurer for the purpose of entering into the insurance contract, which would serve to further impress upon the insured of the existence and importance of the pre-contractual duty of disclosure.[63]

Furthermore, statutory provision should also be made for the expanded warning to be brought to the insured's attention before every renewal of a policy of insurance. Such a practice does not exist in Malaysia at present. As a result, many insureds are oblivious to this continuing duty of disclosure at the point of renewal, because they are unaware that a renewal gives rise to a fresh contract separate from the pre-existing contract of insurance, as opposed to being a mere extension or continuation

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60 Save of course in the case of fraud.

61 This, as pointed out by Whiteley J.C. of the Malaysian Supreme Court in *Teh Say Cheng v. North British and Mercantile Insurance Co. Ltd.* (1921) 2 F.M.S.L.R. 248 at 258, is farthest from the truth.

62 Haemala Thanasegaran,"Insurers' Good Faith in Malaysia: Does a Search for a Fairer Balance in Non-marine Insurance Contracts Lead to Australia?" (2004) 15 Insurance Law Journal 143 at 150.

63 See *CE Heath Underwriting & Insurance (Australia) Pty. Ltd. v. Edwards Dunlop & Co. Ltd.* (1993) 176 C.L.R. 535; *Lumley General Insurance Ltd. v. Delphin* (1990) 6 A.N.Z. Ins. Cas. 60-986.

of the same. As a result, insureds are exposed to possible avoidance of the policy by insurers when an insured loss is suffered, on grounds of non-disclosure of a change in circumstances prior to the renewal of a policy.[64] This was in fact the situation in the recent conventional insurance case of *Leong Kum Whay v. QBE Insurance (M) Sdn. Bhd*.[65]

Another aspect of the insured's duty of utmost good faith towards the insurer (besides the duty of disclosure) is the duty to refrain from making material misrepresentation, which is essentially a false statement of fact addressed to the representee to induce the representee to enter into the contract, and which in fact induces the same. Insurers frequently rely on both non-disclosure and misrepresentation interchangeably to avoid insurance contracts, thus blurring the distinction. The *Takaful Act 1984* (and the *Insurance Act 1996* for that matter) does not explicitly cover pre-contractual misrepresentation. Therefore, section 20 of the *Marine Insurance Act 1906*—which entitles the insurer to avoid the contract for material misrepresentation by the insured (again judged from the onerous standard of the 'prudent insurer')—would presumably apply, irrespective of it having any bearing on the ensuing loss.

Apart from this, the inclusion of 'basis of contract' clauses in proposal forms (which have the effect of giving answers and information provided by insureds) severely reduces the requirement for the insurer to have been 'induced' by the misrepresentation in order for it to be actionable. In fact, almost every type of *takaful* and insurance proposal form in Malaysia contains a 'basis of contract' clause, which has the potential to wreak havoc at the expense of many an unwary insured. This is the position despite there being no juridical basis for its widespread use in today's insurance climate.

Again, it is submitted that amendment to the *Takaful Act 1984* in this respect should look to the Australian package of provisions, namely sections 23, 24, 26, 27, 28, 29, 37, 54 and 56 of the *Insurance Contracts Act 1984* (Cth.). These provisions provide for a comprehensive method of dealing with the same, whereby causal connection to the loss is required to be shown in order for it to be an actionable misrepresentation and the use of 'basis of contract' clauses has in effect been abolished.

Another crucial aspect of the duty of utmost good faith relates to claims settlement practice, one aspect of which would be *takaful* operators (and insurers) resorting to unduly strict construction of policy terms and exclusions. At present, the *Takaful Act 1984* does not deal with this aspect, and it is submitted that perhaps some general provisions in the spirit of sections 13 and 14 of the *Insurance Contracts Act 1984* (Cth.) would serve to deter such conduct, as it would inevitably be a constructive breach by the *takaful* operators of their duty to act in utmost good faith.

As for good faith in claims settlement practice *per se*, it would encompass conduct on the part of insurers like delay, frequent contesting and rejection of claims as well as reduction of policy monies paid out, as a matter of course. Such practice has had a spiralling effect whereby there is a growing trend amongst insureds to put forward exaggerated claims as a counter measure, in anticipation of the now common phenomenon of 'price haggling' between insurers and insureds.

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[64] Thanasegaran, *supra* note 62 at 150.

[65] [2006] 1 C.L.J. 1.

Where an exaggerated claim is put forward with intent to defraud the insurer, there is a clear breach of utmost good faith by the insured, warranting avoidance of the contract. Furthermore, exaggerated claims (without explicit fraud) put forward to accommodate 'price haggling' should not warrant avoidance as a matter of course.[66]

In fact, the Australian Law Reform Commission[67] went so far as to say that "legislation should make it clear that the duty of good faith applies to all aspects of the relationship between insurer and insured, including the settlement of claims." As can be seen from the decision of the South Australian Supreme Court in *Moss v. Sun Alliance Aust. Ltd.*,[68] the duty of utmost good faith under section 13 of the *Insurance Contracts Act 1984* (Cth.) clearly requires insurers to not only promptly admit liability where a valid claim for indemnity is made, but to also make payment thereunder without delay.

At present, there is no specific legislative pronouncement for non-marine insurance and *takaful* in Malaysia with respect to good faith in claims settlement. It would appear to come within the general purview of utmost good faith in section 17 of the *Marine Insurance Act 1906* discussed earlier. This was in fact the case in *Cheong Heng Leong Goldsmiths (KL) Sdn Bhd. v. Capital Insurance Bhd.*,[69] where the Malaysian Court of Appeal held the insurer's handling of the insured's claim to "smack of bad faith" when they, despite their adjuster's report to the contrary, alleged that the robbery of the insured's items had been faked by the insured, just so as to avoid liability and the contract altogether. The Court of Appeal went on to say that bad faith on the part of the insurer would also restrict them from raising or complaining of lack of good faith by the insured.

The Central Bank, however, has issued a set of *Guidelines on Claims Settlement Practice* (the *Guidelines*) for both the life and general insurance as well as *takaful* industries. These *Guidelines* set out certain aspects of conduct and timelines deemed desirable of insurers, but there is no direct sanction for non-compliance. Only indirect methods of issuing show-cause letters are utilised to ensure that insurers and *takaful* operators toe the line. If this fails, then the complainant's legal recourse would most likely be through the Financial Mediation Bureau or the courts.

Although the Mediator has consistently referred to the *Guidelines* in evaluating the adequacy of any *takaful* or insurance complaint brought before him with respect to poor claims settlement practice by insurers, the Central Bank should provide for clear and strict sanctions for non-compliance, for the *Guidelines* to have greater impetus.

In fact, if one looks at the recent developments in the *takaful* and insurance sectors and the financial sector as a whole, a move in such a direction would seem to be inevitable.

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66 See Vincent Ng J.'s judgment with respect to conventional insurance in *Wong Cheong Kong Sdn. Bhd. v. Prudential Assurance Sdn. Bhd.* [1998] 3 M.L.J. 724 at 737-738.

67 Aust., Commonwealth, Law Reform Commission, *Insurance Contracts* (Report No. 20) (Canberra: Australian Government Publishing Service, 1982) at para. 328. Further endorsement of this can be found in para. 35 of the Explanatory Memorandum to the *Insurance Contracts Bill 1984* (Cth.).

68 (1990) 55 S.A.S.R. 145.

69 [2004] 1 C.L.J. 357.

IX. Recent Developments

Since 1984, the Central Bank has adopted a gradual approach towards developing the *takaful* industry in Malaysia. The first phase (1984-1992) witnessed the enactment of the *Takaful Act 1984*, the establishment of Syarikat Takaful Malaysia Sdn. Bhd. (the first *takaful* operator in the country) and the putting in place of the basic infrastructure for the industry. The second phase (1993-2000) then marked the introduction of competition, with MNI-Takaful Sdn. Bhd. (now known as Takaful National Sdn. Bhd.) entering the scene as *takaful* operators. This phase also witnessed greater regional co-operation amongst *takaful* operators, with the establishment of the ASEAN Takaful Group in 1995 and ASEAN Retakaful International (L) Ltd. in 1997 to facilitate re-*takaful* arrangements in the region.

The third phase (2001-2010) then began in tandem with the introduction of the Financial Sector Master Plan (FSMP) by the Central Bank, which has as its objectives the enhancement of the capacity of *takaful* operators and the strengthening of the legal, Syariah and regulatory frameworks. This phase has, amongst others, thus far seen the licensing of 6 new *takaful* operators[70] and the establishment of the Malaysian Takaful Association (MTA) in 2002 in order to improve industry self-regulation.

The Financial Sector Master Plan (a 10-year plan to be implemented in 3 phases) was launched by the Central Bank on 1 March 2001 and provides the blueprint for the development of the financial sector as a whole (of which *takaful* is a part). At its core are recommendations aimed at developing a competitive and dynamic financial system resilient to a more challenging and globalized environment ahead.

In line with one of the main tenets of the Master Plan, *i.e.* to increase consumer awareness and protection, the Insurance Consumer Education Programme was launched by the Central Bank on 29 August 2003. This Consumer Education Programme is a 10-year programme known as InsuransInfo and is a collaborative effort of the Central Bank together with the insurance and *takaful* industries. It is aimed at assisting consumers to make well-informed decisions in selecting insurance and *takaful* products and services, as well as to appreciate their rights and obligations under the policy. InsuransInfo is expected to increase consumer knowledge and awareness in the area, thus promoting greater consumer activism. It is hoped that this will in turn drive the development of an effective and efficient insurance and *takaful* industry with higher standards of market conduct and professionalism.

To streamline and strengthen the consumer redress mechanism and infrastructure of the financial services as a whole, the Financial Mediation Bureau was launched on 20 January 2005. This new body combines and replaces the functions of the formerly separate Banking Mediation Bureau and Insurance Mediation Bureau. The creation of the Financial Mediation Bureau marks an important milestone in enhancing and streamlining the consumer protection infrastructure within the financial services sector. The Financial Mediation Bureau is an independent body staffed by mediators experienced in judicial matters and is a cheap and effective alternative recourse to the courts in handling complaints by aggrieved consumers of *takaful* (and other financial

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[70] Namely MAA Takaful Berhad, CIMB Aviva Takaful Bhd., Hong Leong Tokio Marine Takaful Bhd., Prudential BSN Takaful Bhd., HSBC Amanah Takaful (Malaysia) Sdn. Bhd., and Etiqa Takaful Bhd.

services) products, who have first submitted their complaints to the Complaints Unit[71] of the respective *takaful* operator.

The services of the Financial Mediation Bureau (offered free of charge to the public) is funded through levies on individual member companies in the financial services sector by the respective banking, insurance and *takaful* trade associations. For insurance and *takaful* related disputes, the Financial Mediation Bureau will handle all disputes between claimants and operators, not exceeding Ringgit Malaysia Two Hundred Thousand for motor and fire insurance plans, Ringgit Malaysia One Hundred Thousand for other plans, Ringgit Malaysia Five Thousand for third-party property damage. The effect of a decision by the Financial Mediation Bureau in the claimant's favour is that the *takaful* operator must settle the mediated sum directly to the claimant within 30 days of the decision. In addition, matters not within the jurisdiction of the Financial Mediation Bureau, or which cannot be resolved by the respective *takaful* operator's Complaints Unit, may be referred to the Islamic Banking and Takaful Department of the Central Bank instead.[72]

To cater for mainstream resolution of *takaful* disputes, the Regional Centre for Arbitration in Kuala Lumpur was chosen to arbitrate cases concerning Islamic banking and *takaful*. This Centre complements the specialised High Court assigned in 2003 to adjudicate such cases, and the Financial Mediation Bureau. This, along with the enlarged and reinforced scope of the Syariah Advisory Council in 2003 and the issuance of the *Guidelines on the Governance of Syariah Committees* for Islamic financial institutions, is reflective of the strengthening of the consumer redress infrastructure within the industry.

On the international front, the Central Bank and the Islamic Development Bank signed a Memorandum of Understanding on 30 June 2004 which seeks to promote and expand *takaful* and re-*takaful* business among the Organisation of Islamic Conference (OIC) member countries, with focus being directed at promoting ASEAN Retakaful International (L) Ltd. as the main re-*takaful* operator for OIC member countries. Apart from this, the Group of Developing Eight (D-8) countries also made progress during their inaugural meeting convened on 13 July 2004 by the Central Bank to set up a mechanism for co-operation in the development of *takaful* and re-*takaful* among the D-8 nations.

And in September 2006, the Central Bank approved the licences of 2 additional re-*takaful* companies, namely Munich Re and MNRB Holdings Berhad. Malaysia is also aggressively promoting itself as a major Islamic financial hub, with the setting up of the Malaysia Islamic Financial Centre (MIFC) where international Islamic banks and *takaful* operators will enjoy, amongst other things, a 10-year tax exemption under the *Income Tax Act 1967*, with effect from the year of assessment 2007.

X. Conclusion

It is human nature that anything new will not normally be easily and readily accepted. When *takaful* was first introduced as an Islamic alternative to conventional insurance

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71 As of June 2003, every insurance and *takaful* operator must have in place a Complaints Unit as its first point of redress for consumers.

72 Matters concerning conventional insurance may be referred to the Customer Services Bureau of the Central Bank.

in the early eighties, there were strong reservations that it would not be viable. Now, twenty years on, the *takaful* system has developed, and the Malaysian model has turned out to be viable to both participants and shareholders alike and appears to be having regional appeal. This is more so because the Malaysian model set out by the *Takaful Act 1984* acknowledges the commercial character of *takaful*, whilst presenting it as a scheme based on brotherhood and solidarity by colouring its terminology in that vein, using words and expressions such as 'family solidarity' for life insurance and 'contribution' for premiums.[73]

It is important that the development of the *takaful* industry is no longer to be viewed in isolation, but as an integral component of the Islamic financial system, more so with the continued blurring of traditional financial lines with products like *bancatakaful*. This, along with *takaful*'s increased regional appeal as a commercially-driven operation (as opposed to a purely social-cooperative type scheme, as adopted by some jurisdictions), begs for a substantive legal framework to be put in place, clearly outlining consumers' legal rights and obligations, so as to truly complement the efforts taken thus far in enhancing the institutional, regulatory and prudential frameworks for consumer awareness and protection.

As it stands, the Central Bank and the industry seem to have done much in putting in place an effective consumer redress infrastructure (with the Financial Mediation Bureau) and a consumer education programme to help evolve the Malaysian consumer psyche into being more rights-conscious. However, to not simultaneously address and legislate on the core principles of *takaful*—like the duty of utmost good faith, disclosure, insurable interest, proper claims settlement practice and the corresponding rights and remedies attached—in a clear fashion will result in much of the efforts taken to have been in vain. Addressing the substantive consumer protection provisions will thus augur well for the Central Bank's aim of improving consumer protection and professionalism in the industry as part of its Financial Sector Master Plan.

A fact which is often overlooked is that the Islamic financial system, including *takaful*, is open to all and not meant solely for Muslims. Also, the concept of *takaful* and conventional insurance is essentially the same, in that they both involve the pooling of funds to help one in need. What differs is essentially the practice of profit-sharing and the prohibition and permissibility of certain investments in *takaful*.

Hence, by addressing some of the substantive issues pertaining to good faith, disclosure, insurable interest, proper claims settlement practice and the corresponding remedies highlighted above, *takaful* would not only be put on the same footing as conventional insurance in Malaysia, it may be made even more attractive to the insuring public (at least until such time that the *Insurance Act 1996* is also revamped), as it is fundamentally based on concepts of fairness, honesty and justice. Even if and when the legislature deems fit to improve the *Insurance Act 1996*, *takaful* would already be on the same footing, and as such would truly be viewed as both a viable and marketable alternative to conventional insurance, not just in Malaysia but in the region.

[73] Khorshid, *supra* note 7 at 121.