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ISLAMIC INSURANCE IN MALAYSIA: INSIGHTS FOR THE INDIAN INSURANCE INDUSTRY

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This article looks at the development and characteristics of Islamic insurance (*takaful*) which is compatible with the principles of Islamic finance, thereby making it acceptable and attractive for millions of Muslims as an alternative to conventional insurance. In so doing, this article provides a detailed review on the evolution of *takaful* in the context of the Malaysian insurance sector which is among the largest players in the global *takaful* market. Taking cues from the success of *takaful* in Malaysia, this article explores certain key tenets of *takaful* and micro-*takaful* (low-cost *takaful*) that can be translated specifically into the Indian context when the market eventually opens up and possibly into other developing and developed markets with substantial Muslim populations.

I. INTRODUCTION

Insurance is an important and growing part of the financial sector in virtually all developed and some developing countries. A resilient and well-regulated insurance industry can significantly contribute to economic growth and efficient resource allocation through the transfer of risk and the mobilisation of savings. In addition, it can enhance financial system efficiency by reducing transaction costs, creating liquidity, and facilitating economies of scale in investment.[1] Insurance, like the banking sector, has been adversely affected by the global financial crises with premium growth declining by 0.8% in real terms in 2011, but nonetheless the insurance industry's growth over the past three decades has been 4.2% which is performing well above the global Gross Domestic Product (GDP) growth rate of 3.4%.[2] Many opportunities remain, especially in emerging markets (such as India and China) which have registered impressive growth. In 2010, emerging markets clocked an impressive 11% premium growth (in real terms) compared to just 1.4% in industrialised countries.[3] Overall the insurance industry is recovering well from the crisis, thanks to robust

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1 Udaibir S. Das, Nigel Davies & Richard Podpiera, "Insurance and Issues in Financial Soundness" (2003) IMF Working Paper WP/03/138 at 3.

2 International Monetary Fund ("IMF") real GDP growth figures for the period 1980-2010, see online: IMF <http://www.imf.org/external/datamapper/index.php>; and Swiss Re Sigma Explorer real premium growth figures for the period 1980-2010, see online: Swiss Re <http://www.sigma-explorer.com>.

3 Swiss Re, "World Insurance in 2010" (2011) Sigma Report No. 2/2011 at 1.

and steady demand in insurance in emerging markets, particularly in Asia, which are expected to grow strongly in coming years.

In spite of the tremendous strides that the insurance sector has made over the past decades, insurance awareness and its acceptability still remains low particularly in the developing markets of Asia and Africa. Several reasons attributed to weak insurance penetration, such as poor financial literacy, low income of prospective customers in these regions, high sense of optimism and risk-taking affinity of people that negate the need for insurance, lack of innovative products commensurate to their needs and exposure to risks *etc*., further contribute towards the weak perception of insurance and its acceptance as a potent tool for risk management and investment. Besides that, there is a lot of negativism towards insurance because of socio-cultural and religious factors. It is in this context that this article looks at the concept and success of Islamic insurance (*takaful*) in a developing market (Malaysia), its regulatory framework and its implications towards an increase in insurance awareness and acceptance among people. The paper also underlines and further discusses the significance of *takaful* for other developing markets with sizeable Muslim populations (like India) as a tool for enhancing awareness and product innovation, thereby making insurance acceptable and attractive for millions of people who are beyond the ambit of insurance cover. *Takaful* could further target and appeal to niche market segments in developed markets (like the U.S., Europe *etc*.) with sizeable Muslim populations, many of whom hitherto were reluctant to buy a non-Islamic financial product.

The objective of this article is therefore to provide a detailed review on the development of *takaful*, its characteristics as well as its future evolution. Taking cues from the success of *takaful* in Malaysia, this article explains how *takaful*, which is still in its infancy, could be further developed in other markets with substantial Muslim populations. This article got several insights during interactions with the speakers at the Faculty Development Programme held in Kuala Lumpur between 29 and 30 October 2012. This was followed by an extensive literature review encompassing this area, therein identifying several issues and challenges facing the insurance industry, Islamic finance and *takaful* in developing markets, with particular focus on the Malaysian *takaful* sector. Sources for literature review included (but were not limited to): insurance reports and statistics from Swiss Re, Bank Negara Malaysia (the Central Bank of Malaysia),[4] the International Labour Organisation ("ILO") and Islamic Financial Services Board ("IFSB") *etc*. The research then focused particularly on academic articles in the core area of *takaful*.[5]

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4 'Bank Negara Malaysia', 'Central Bank of Malaysia', 'Malaysian Central Bank' or 'Central Bank' will be used interchangeably in this paper.

5 See *e.g.*, Haemala Thanasegaran, "Growth of Islamic Insurance (*Takaful*) in Malaysia: A Model for the Region?" [2008] Sing. J.L.S. 143 [Thanasegaran, "Growth of Islamic Insurance in Malaysia"]; Hania Masud, "*Takaful*: An Innovative Approach to Insurance and Islamic Finance" (2010) 32 U. Pa. J. Int'l L. 1133 [Masud, "*Takaful*: An Innovative Approach"]; R. Qaiser, "Takaful—The Islamic Insurance", online: National Insurance Academy, Pune <http://www.niapune.com/pdfs/Research/TAKAFUL%20 INSURANCE.pdf> [Qaiser, "Islamic Insurance"]; Aly Khorshid, *Islamic Insurance: A Modern Approach to Islamic Banking* (New York: Routledge, 2004) [Khorshid, *A Modern Approach*]; Ramin Cooper Maysami & Au Pui Khuan, "Islamic Insurance in Malaysia: A Successful Model in Operation" (1998) 6(3) Int'l Ins. L. Rev. 79 [Maysami & Au, "A Successful Model"]; Ramin Cooper Maysami & John Joseph Williams, "Evidence on the Relationship between Takaful Insurance and Fundamental Perception of Islamic Principles" 2 Applied Financial Economics Letters 229 [Maysami & Williams,

The remainder of the article is organised as follows. The next section provides a brief outline of the insurance industry on a global and emerging market level. This is followed by an explanation of the concept and key characteristics of *takaful*, its compatibility with the principles of Islamic finance as well as the key differences between *takaful* and the conventional insurance model. The subsequent section elaborates on the growth and success of *takaful* in Malaysia, and the proceeding section focuses upon cues that the Indian insurance sector can draw from the success of *takaful* in Malaysia, that could ultimately help in the introduction and growth of *takaful* in India in the near future. Finally, the article concludes with recommendations and suggestions for taking *takaful* forward, briefly discussing the concept of micro-*takaful* and its relevance for low-income and religiously conscious markets, while also outlining challenges and opportunities facing *takaful* in its quest for the overall development of the insurance industry and achieving financial inclusion.

II. Overview of the Insurance Industry

Insurance, along with banking services and stock markets, forms the backbone of the financial services industry. Not only does it help in adequate risk management of various economic and commercial activities, it also helps to regulate the financial industry in an effective way. The global insurance industry is concentrated in industrialised nations[6] which constituted about an 84% share of the world market in 2012. The remaining 16% is distributed among the emerging markets (up from 8.7% in 1999). The global insurance premium volume was US$4.6 trillion in 2012, which accounted for 6.5% of global GDP.[7] Extensive analysis of the global insurance industry outlines several challenges and opportunities that are presented by this fast emerging yet nascent sector, some of these key factors[8] being: the 'financial market crisis', the 'deepening recession', 'global strategic business risks' including regulatory intervention, climate change and catastrophic events, demographic shifts in core markets, and 'rise of emerging markets' reflected by impressive growth of insurance sector in these markets.

Over the past two decades, the insurance industry has grown spectacularly in emerging and developing markets particularly in the Asian region. This is due to the high growth of the 'Asian tigers' usually referred to as the economic liberalisation and boost in trade in Southeast Asian nations (like Thailand, Malaysia, Vietnam *etc*.) along with the rise of big emerging markets such as China and India where

"Relationship between Takaful and Islamic Principles"]. Insights from academic papers were complemented by industry and consulting reports such as Deloitte, PWC, Ernst & Young, A.M. Review, World Islamic Insurance Directory *etc*.

6 Industrialised or advanced nations are classified as: North America, Western Europe (excluding Turkey), Japan, Hong Kong, Singapore, South Korea, Taiwan, Oceania and Israel, while emerging markets comprise Latin America, Central and Eastern Europe, South and East Asia, the Middle East (except Israel), Central Asia, Turkey and Africa: Swiss Re, "World Insurance in 2011: non-life ready for take-off" (2012) Sigma Study No. 3/2012 at 28.

7 Swiss Re, "World Insurance in 2012: Progressing on the long and winding road to recovery" (2013) Sigma Report No. 3/2013 at 33.

8 Factors were identified through extensive literature review of the global insurance industry based on primary data collected by the author as well as from secondary sources such as insurance reports (*e.g.*, Swiss Re, Munich Re, Lloyds, IMF, Geneva Association, ILO *etc*.) and consulting reports on the insurance sector (*e.g.*, Deloitte, Ernst & Young *etc*.).

among several liberalisation steps taken by these countries was the deregulation of their insurance industry which was opened (although partially) to foreign insurance players. The rise of these emerging markets at one end is providing new avenues for growth of the insurance industry in low-penetration regions such as Asia, Africa and Latin America, but it is also posing serious challenges in catering to these markets due to lack of insurance awareness, different demographics and their low purchasing power. This is confronting the industry to reinvent the way in which it operates and also urging them to be more innovative, be it in products, processes, or services, so as to achieve greater insurance penetration and growth especially in developing markets.

In spite of some short term challenges and difficulties for the insurance market, on a long term view the scope and opportunities for this industry remain bright and optimistic. Greater liberalisation of the economy and deregulation of the insurance market coupled with rising domestic demand and increasing insurance awareness mean that the insurance industry is projected to be one of the beneficiaries of the rise of these developing economies. Therefore, a growing apprehension of market saturation in industrialised economies and the further liberalisation and deregulation that are taking place in emerging markets continue to keep the latter in the spotlight.[9]

The insurance industry globally is therefore striving to make inroads into the vast un-served and under-served insurance markets particularly in emerging countries. In addition to the low income of the people coupled with insurance awareness and financial literacy being weak in such markets, there is also the core issue of insurance not being compatible with the socio-cultural and religious beliefs of a large segment of the market which impedes the acceptance of insurance as an effective tool for managing risks. The next section elaborates upon how the insurance industry literally came up with an innovative product that makes insurance (as a concept) compatible with the religious principles of Muslims, thus giving an opportunity to tap into this huge, previously un-served market segment.

III. *Takaful*: Compatible with Principles of Islamic Finance

One of the key challenges facing the development of the insurance industry in developing markets has been ‘low awareness and acceptance towards insurance’ among prospective customers. This is further aggravated by a sense of negativism towards the concept of insurance because of certain socio-cultural and religious barriers. This is evident from the fact that for millions of Muslims the conventional insurance products are considered un-Islamic as they do not comply with Islamic principles. According to Islamic jurists, conventional insurance is not aligned to the Shariah, the body of Islamic law.[10] In understanding Islamic finance, it is important to start with a brief overview of Islamic law because Islamic finance is the application of Islamic law to financial and commercial transactions. Islamic law (Shariah) is derived from the Quran (Islam’s holy book) and the Sunnah (actions and sayings of Prophet

[9] Swiss Re, “Exploiting the growth potential of emerging insurance markets: China and India in the spotlight” (2004) Sigma Report No. 5/2004.

[10] Shariah (Sharī`ah) refers to divine Islamic law that encompasses all aspects of human life as revealed in the Qur’an and the Sunnah—definition as adopted by IFSB, see online: IFSB <http://www.ifsb.org/terminologies.php> [IFSB Terminologies].

Muhammad). Although Shariah is at the core of Islamic finance, contributions by the Shariah Supervisory Board ("SSB")[11] and leading Islamic finance bodies (such as IFSB[12] and AAOIFI[13]) are critical as they promote the development of a prudent and transparent Islamic financial services industry through the introduction of new (or adapting existing) standards consistent with Shariah principles. These, coupled with inputs from regulatory and legal provisions of the given market(s), help suggest relevant laws for the *takaful* industry.

Islamic finance is in no way against the conventional financial system, rather the objective is to embed Islamic values and ethos within the conventional financial services industry.[14] In so doing, Islamic financial products (be it banking, insurance or capital markets) emerge as a credible and legitimate option for a large un-served market segment which was hitherto averse to buying conventional financial services products. In the case of insurance, the conventional insurance product does not necessarily follow Shariah law making it incoherent with the Islamic financial system. Hence, roughly 1.6 billion Muslims accounting for 23.4% of the world population[15] are under-served by the insurance sector due to the lack of an appropriate insurance product congruent with their religious principles.

Globally the Muslim population is forecasted to grow at about twice the rate of the non-Muslim population over the next two decades—an average annual growth rate of 1.5% for Muslims, compared with 0.7% for non-Muslims. The world's Muslim population is expected to increase by about 35% in the next 20 years to reach 2.2 billion by 2030.[16] It must be noted that millions of Muslims do buy insurance, but for many conservative Muslims buying insurance comes in direct conflict with their

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11 Shariah supervision is the single most important element that distinguishes a conventional financial institution from an Islamic financial institution. SSB or Shariah committees, fatwa authorities *etc.*, therefore assume importance as the pillar of Islamic financial institutions. SSB comprises a group of jurisprudence scholars and economists engaged by the institutions offering Islamic financial services to supervise and ensure its Shariah compliance and governance system—adapted from Ahmad Alkhamees, "The Impact of Shari'ah Governance Practices on Shari'ah Compliance in Contemporary Islamic Finance" 14 Journal of Banking Regulation 134; and by IFSB, see online: IFSB <http://www.ifsb.org/terminologies.php> [IFSB Terminologies].

12 The IFSB is based out of Kuala Lumpur and started operations on 10 March 2003. It serves as an international standard-setting body of regulatory and supervisory agencies that have a vested interest in ensuring the soundness and stability of the Islamic financial services industry, which is defined broadly to include banking, capital market and insurance. IFSB is a leading Islamic finance body with 184 members (as of April 2014), comprising 59 regulatory and supervisory authorities, 8 international inter-governmental organisations, 111 financial institutions and professional firms as well as 6 self-regulatory organisations (Industry Associations and Stock Exchanges) operating in 45 jurisdictions—see online: IFSB <http://www.ifsb.org>.

13 The Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI") is an Islamic international autonomous not-for-profit corporate body that prepares accounting, auditing, governance, ethics and Shariah standards for Islamic financial institutions and the industry—see online: AAOIFI <http://www.aaoifi.com>.

14 For instance, the work of Islamic finance bodies (such as IFSB) complements that of the Basel Committee on Banking Supervision, International, International Association of Insurance Supervisors and Organisation of Securities Commissions.

15 Pew Research Center: Forum on Religion & Public Life, "The Future of the Global Muslim Population" (January 2011) at 13, online: Pew Research Center <http://www.pewforum.org/files/2011/01/FutureGlobalMuslimPopulation-WebPDF-Feb10.pdf> [Pew Research Center, "Global Muslim Population"].

16 New population projections by the Pew Research Center's Forum on Religion & Public Life: *ibid.*

religion and belief system. Often various 'fatwas' (religious decrees)[17] are issued declaring insurance as un-Islamic and that opting for an insurance policy goes against the tenets of Islam. "The insurance policy is unlawful as it is based on interest and gambling", said one of the fatwas.[18] Nevertheless the need for Shariah-compliant insurance among Muslims remains and has become all the more acute, and in doing so there is a huge business potential to tap. The response to this need has come in the form of what is called '*takaful*'—*an insurance product compatible with the principles of Islamic finance*. *Takaful* is not only an innovative approach to Islamic finance, but also a viable alternative to conventional insurance[19]

Takaful is derived from an Arabic word that means 'joint guarantee', whereby a group of participants agree among themselves to support one another jointly for the losses arising from specified risks. In a *takaful* arrangement, the participants contribute a sum of money (known as '*tabarru*' commitment)[20] into a common fund that will be used mutually to assist the members against a specified type of loss or damage.[21] The concept of *takaful* as such is not new in Islamic commercial law. Islam accepts the principle of reciprocal compensation and joint responsibility. The system of *takaful* insurance tends to achieve self-reliance through a self-sustaining insurance system based on community pooling, solidarity and joint guarantee for the well-being of the community and individuals in need, the entire system and operation being based on Islamic principles.[22] *Takaful* therefore takes care of all the Shariah-related concerns including ensuring that the investment is made in Shariah-compliant instruments. *Takaful* was initially undertaken in Sudan in 1979 and subsequently in Malaysia in 1984. *Takaful* operations have opened up in many countries in the past three decades, especially those with large Muslim communities such as Indonesia, Pakistan, Bangladesh, Egypt *etc*. The next section will explain how and why *takaful* is different from the conventional insurance model, while identifying the variety of *takaful* models prevalent across various markets.

IV. Comparison Between *Takaful* and Conventional Insurance

The concept of insurance where common resources are pooled in order to help the needy does not contradict the teachings of Islam, which in any event propagates solidarity, mutual help and cooperation among members of the community. Muslim

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17 Fatāwa (fatwa) is a juristic opinion or pronouncement of facts given by the Sharīah board, a mufti, or a faqīh on any matter pertinent to Sharīah issues, based on the appropriate methodology: see IFSB Terminologies, *supra* note 10.

18 Fatwa issued by Darul Uloom Deoband, the most influential Sunni Muslim seminary in the Indian subcontinent (2010). See "Insurance policy unIslamic, says Deoband fatwa", online: The Economic Times <http://articles.economictimes.indiatimes.com/2010-05-15/news/28482475_1_fatwadarululoom-deoband-darul-ifta>.

19 See Masud, "*Takaful*: An Innovative Approach", *supra* note 5 at 1133.

20 *Tabarru* is a commitment to donate, contribute or relinquish a portion from the contributions as a donation for fulfilling obligation of mutual help which is used to pay claims submitted by eligible claimants. *Tabarru* is incorporated in order to eliminate the element of uncertainty in the *takaful* contract: see IFSB Terminologies, *supra* note 10.

21 Definitions and Terminologies adopted from IFSB: see IFSB, "Guiding Principles on Governance for *Takāful* (Islamic Insurance) Undertakings" (December 2009) at 27, online: <http://www.ifsb.org/standard/ED8Takaful%20Governance%20Standard.pdf>.

22 See Qaiser, "Islamic Insurance", *supra* note 5 at 4.

scholars, however, differ in their views on the permissibility (*halal*) or prohibition (*haram*) of insurance. Some accept insurance in its traditional form as 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*).[23] 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 Shariah.

Under conventional insurance, *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, 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.[24]

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.[25] Therefore, the operation of an insurance system conforming to the rules and requirements of Shariah 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 Shariah was needed. Hence, *takaful* was established as an 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 for a defined loss from a defined fund. It is therefore a scheme where the participants themselves are the insured(s) as well as the insurer(s).[26] The fundamental basis of the *takaful* concept is quite similar to the cooperative and mutual insurance, to the extent that the cooperative and mutual model is one that is most accepted under Islamic law.[27]

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23 See Maysami & Williams, "Relationship between Takaful and Islamic Principles", *supra* note 5.

24 See Khorshid, *A Modern Approach*, *supra* note 5.

25 See Maysami & Au, "A Successful Model", *supra* note 5.

26 See Thanasegaran, "Growth of Islamic Insurance in Malaysia", *supra* note 5 at 146.

27 See Toon Bullens, "Challenges for Micro Insurance Companies" (2006) at 2, online: Asian Knowledge Centre for Mutual Insurance <http://www.askmi.in/docs/Training%20material/11%20Challenges%20for%20microinsurance%20companies.pdf>.

The policyholders (*takaful* partners) pay a subscription to assist and indemnify each other and share the profits. The profit is earned from business conducted with the subscribed fund. There are two prevailing *takaful* models namely: '*Mudarabah*' and '*Wakalah*' which are based on accepted financing practice permitted in Islam. The *Mudarabah* model (profit-sharing model)—when translated to English it would mean a profit and loss sharing model where both the *takaful* provider and the participant share the surplus (profit)—is a form of business contract in which one party brings capital and the other personal effort and the required skill. The proportionate share in profit is determined in advance by mutual agreement. This model is used in Malaysia. On the other hand, the *Wakalah* model (agency model) is a fee-based model, where the *takaful* provider acts as an agent for the participants and manages the *takaful* fund for a fee. This model is generally used in the Middle East. There is a third 'hybrid model' which is a combination of both the *Mudarabah* and *Wakalah* models, while a fourth model called the '*Waqf*' (endowment) model[28] can be found in Pakistan.

Takaful products are sold by companies set up as fully Islamic firms, where the entire business operations are undertaken in accordance with Shariah. Alternatively, *takaful* products can be sold by conventional financial institutions through an Islamic window that allows customers to purchase Shariah-compliant products and services. Such institutions may also sell conventional products. A comparison between the conventional insurance model and the *takaful* model is provided in Exhibit 1 below.

Mutual or cooperative insurance, in contrast to the conventional stock-owned insurance, shares some similarities with *takaful*.[29] It is owned by the policyholders (as in *takaful*) and its corporate strategy and mission is grounded in the best interests of the policyholders and to satisfy their common needs and not solely to make profits or provide a return on capital. Therefore, *takaful* in principle contains many characteristics of mutual insurance, as both are managed according to solidarity or joint guarantee principles between members, promote self-reliance and a self-sustaining model for community well-being, assist those that need assistance, and follow a community pooling system.[30] Nevertheless, the primary difference between the mutual

[28] The *Wakalah Waqf* model has proven popular in Pakistan and relies upon an initial donation from the shareholders to establish a *Waqf* fund for the participants. Only the investment returns from this fund (and not the *Waqf* amount itself) may be used to pay claims. Contributions are managed through the combined model with shortfalls in the participations' fund being met through a *Qard* facility from shareholders. Pakistani Shariah scholars do not allow surplus distribution amongst participants—see Ernst & Young, "Global Takaful Insights 2013—Finding growth markets" (2013) at 78, online: Ernst & Young <http://www.ey.com/Publication/vwLUAssets/ET_Global_Takaful_Insights_2013/$FILE/EY-global-takaful-insights-2013.pdf>.

[29] Mutual companies are often facing financial constraints though as they cannot raise additional capital (their only source of equity capital is retained earnings) to expand and compete against traditional insurers, which often led to demutualisation in the past. It is instructive to note that many, if not most, mutual insurance companies in the West have de-mutualised and become stock-owned insurance companies. Apparently all that is needed is a majority approval by the policyholders and approval by the regulator. Such large insurance companies as Liberty Mutual, New York Life, Metropolitan Life, John Hancock and Prudential, all started out as mutual insurance companies, but were subsequently de-mutualised: see Richard Rambeck, "Mutual Holding Company: A Shell Game Without the Pea" (30 April 2001), online: Insurance Journal <http://www.insurancejournal.com/magazines/partingshots/2001/04/30/18694.htm>.

[30] Adapted from: Serap O. Gönülal, ed., *Takaful and Mutual Insurance: Alternative Approaches to Managing Risks* (Washington, D.C.: The World Bank, 2013); International Cooperative & Mutual Insurance Federation ("ICMIF"), Sabbir Patel, "Dynamics of the Cooperatives, Mutual Insurance &

Exhibit 1.
Comparison between Conventional Insurance and *Takaful*.

Characteristics	**Conventional Insurance**	***Takaful* (Islamic Insurance)**
Owners	Shareholders own the insurance company. The objective is to maximise profits.	Policyholders own the company. The operator receives compensation (through profit-sharing or fees). The objective is to minimise the cost of insurance.
Company	Relationship between the company (insurer) and policyholder (insured) is on a one-to-one basis.	Company is better known as an operator, which acts as a trustee, manager and also entrepreneur.
Contract	An exchange contract (sale and purchase) between the insurer and insured. Insurance is a buy-sale contract, in which policies are sold and the policyholders are the purchasers.	A combination of a *tabarru* contract (donation) and agency or profit-sharing contract. Participants own the *takaful* funds which is managed by the operator. Participants give up individual rights to gain collective rights over contribution and benefits.
Responsibility of Policyhold-ers/Participants	Policyholders pay the premium to the insurer.	Participants make a contribution to the scheme. Participants mutually guarantee each other under the scheme.
Liability of the Insurer/Operator	Risk of loss is assumed by the shareholders. The insurer is liable to pay the insurance benefits as promised from its assets (insurance funds and shareholders' fund).	Risk of loss is assumed by policyholders. The *takaful* operator acts as the administrator of the scheme and pays the *takaful* benefits from the *takaful* funds.
Investment of Fund	There is no restriction apart from those imposed for prudential reasons. Funds may be invested in an interest-based scheme. They can be invested in any scheme or project that may not necessarily be supported by Shariah discipline.	Assets of the *takaful* funds are invested in Shariah-compliant instruments. The investments must be Shariah-compliant. The funds shall be invested in any interest-free scheme justified by Shariah. The investment returns must not be driven from or by any unethical activities and the entire procedure must comply with Shariah guidelines.

Exhibit 1.
(*Continued*)

Characteristics	Conventional Insurance	***Takaful*** **(Islamic Insurance)**
Underwriting Surplus	Management decides at various times how this should be distributed between shareholders and policyholders. As a result, there is a conflict of interest.	How exactly the surplus is distributed and in what proportion is specified in the *takaful* contract.
Sources of Law & Regulation	Man-made, based on human thoughts and culture.	A Shariah board consisting of Islamic scholars helps ensure that the operations, products and investments are Shariah-compliant.
Winding up of Company	Reserves and surpluses belong to shareholders.	Reserves and surpluses are returned to policyholders or donated to charity.

Adapted from: Bank Negara Malaysia: The Malaysian *Takaful* Industry 1984-2004; Bt. Esman, N. K., "Comparison between *Takaful* and Insurance." (2008) Working Paper, Faculty of Economics and Muamalat, Universiti Sains Islamia Malaysia; Ernst & Young (2013), "Global *Takaful* Insights 2013—Finding Growth Markets".

insurance and *takaful* models is the epistemological origins and the Shariah norms and prohibitions related to *riba*.[31] There are some distinct characteristics between *takaful* and mutual insurance, for example, the former uses *tabarru* contracts or unilateral gratuitous promises to contribute, combined at times with *Wakalah* and/or *Mudarabah* operator agreements, while the latter uses bilateral policies. Other differences between them relate to the sharing of underwriting surpluses and governance structure.

Of late, questions have been raised as to whether *takaful* is just mutual insurance with Islamic tenets. The answer cannot be simplistic, as modern day *takaful* is a hybrid between a shareholding company operating under Islamic financial rules and a mutual/cooperative risk pool where the risk is shared by the participants and not

Takaful", Presentation at Mutual Insurance and Takaful in a Changing World (12 November 2012), online: ICMIF <http://www.takaful.coop/images/stories/World%20Bank%20Takaful%20conference%20Istanbul%20Final%20Nov%202012.ppt>; Definition of Mutual Societies by the European Commission: see European Commission, "Consultation Document: Mutual Societies in an enlarged Europe" (3 October 2003) at 5, online: European Commission <http://ec.europa.eu/enterprise/policies/sme/files/mutuals/mutuals-consult-doc_en.pdf>.

31 Dawood Y. Taylor, "Risk Management and Disclosure in Takaful Practices" Presentation at The World Takaful Conference (12 to 13 April 2010), online: Islamic Business Researches Center <http://www.kantakji.com/media/9111/13-dawood-taylor.pdf>; Shamser Mohamad, "An Overview of Takaful in Malaysia" (2012)—Project Paper, International Center for Education in Islamic Finance ("INCEIF") at 10, see online: INCEIF <http://www.slideshare.net/maceabdullah/an-overview-of-takaful-in-malaysia121412final>.

transferred to the operator.[32] It must be mentioned that Saudi Arabia (a leading *takaful* market) operates under the cooperative model, and in 2005 the Saudi Arabia Monetary Authority ("SAMA") enacted regulations for cooperative insurance supervision, while in 2011, SAMA directed all operators to align with the cooperative insurance model, thus differing from the pure *takaful* model operating in other countries.[33]

Although various Islamic insurance versions have been adopted in Muslim countries, *takaful* is the most accepted model of Shariah-compliant insurance. In 2007, Muslim countries accounted for 23% of the emerging market's GDP. About 11% of insurance premiums (*i.e.* US$45 billion) were written in these countries. Of this amount, roughly 4% (*i.e.* US$1.7 billion) were written under *takaful* schemes. Between 2004 and 2007, the average annual growth rate for *takaful* was estimated at 25% (adjusted for inflation) versus 10.2% in the conventional market.[34] Globally, the *takaful* industry has been growing rapidly, appealing to both Muslims and non-Muslims. The global *takaful* contribution grew by 19% in 2010 to US$8.3 billion, while in 2012 it is expected to reach US$12 billion. The industry is projected to further grow by 15 to 20% annually.[35] In 2010, there were 181 *takaful* operators worldwide, up from 38 players a decade ago,[36] thus indicating the growing relevance and need for *takaful*. Overall, *takaful* continues to grow and is set to outpace growth in conventional insurance in the long term, while the *takaful* market share in Muslim countries is projected to increase from 4% in 2007 to over 8 to 10% by 2015. A Sigma study (2008) analysed five major markets *i.e.* of Bahrain, Indonesia, Malaysia, Saudi Arabia and the United Arab Emirates, wherein they identified Malaysia and Saudi Arabia as the two *takaful* markets with the largest growth potential.[37] The following section elaborates upon the development and growth of the Malaysian *takaful* market which remains one of the leading and most sophisticated *takaful* markets globally.

V. Development of *Takaful* in Malaysia

Malaysia is a newly industrialised economy with an upper-middle income level and GDP per capita ("PPP") of US$16,922 in 2012.[38] In comparison to the Middle East

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[32] Adapted from: ICMIF, "Is takaful just mutual insurance with Islamic tenets?", online: ICMIF <http://www.takaful.coop/index.php?option=com_content&view=article&id=566:is-takaful-just-mutual-insurance-with-islamic-tenets&catid=15:takaful-exchange&Itemid=141>; Nick Ramlah Mahmood, "Takaful: The Islamic System of Mutual Insurance—The Malaysian Experience" (1991) 6 Arab L.Q. 280.

[33] See Ernst & Young, "Global Takaful Insights 2013", *supra* note 28 at 10, 11.

[34] See Swiss Re, "Insurance in the Emerging Markets: Overview and Prospects for Islamic Insurance", (2008) Sigma Report No. 5/2008 at 4 [Swiss Re, Sigma Report No.5/2008].

[35] Based on projection by Ernst & Young, "The World Takaful Report 2012"; Ernst & Young, "Global Takaful Insights 2013", *supra* note 28. See also Middle East Insurance Review ("MEIR"), *World Islamic Insurance Directory 2013* (Singapore: Ins Communications Pte. Ltd., 2013).

[36] See Hans de Cuyper, Presentation on "Takaful Business—Challenges and Opportunities"—Etiqa Insurance & Takaful, Presentation at Life Insurance Conference (2012), online: <http://www.actuaries.org.sg/?q=disknode/get/1001>.

[37] See Swiss Re (2008), Sigma Report No. 5/2008, *supra* note 34 at 4.

[38] IMF 2012 GDP per capita based on purchasing power parity ("PPP") figures, see online: IMF <http://www.imf.org/external/pubs/ft/weo/2013/01/weodata/weorept.aspx?pr.x=43&pr.y=10&sy=2012&ey=2012&scsm=1&ssd=1&sort=country&ds=.&br=1&c=548&s=PPPPC&grp=0&a=#cs1>.

and other Muslim countries, the Malaysian insurance industry is much developed with relatively high insurance awareness.[39] Over the past two decades, *takaful* has become quite popular in Islamic countries and has particularly gained deep roots and acceptability in Malaysia which is one of the biggest and most developed *takaful* markets in the world.[40] Malaysia has emerged as the world's leading family *takaful* market[41] and enjoys 71% share of gross *takaful* contributions in the ASEAN (Association of Southeast Asian Nations) region. With a proven model and regulatory clarity, the country is set to further build on this leadership position and continue to guide other markets in and around Southeast Asia.[42]

The Malaysian insurance industry though relatively small by international standards has achieved significant progress over the past two decades and has been among the ten biggest contributors to emerging market premium growth between 2002 and 2007. In Malaysia, the insurance industry has been regulated by Bank Negara Malaysia since 1 May 1988. Prior to that, the Ministry of Finance regulated the industry as per the *Insurance Act 1963*[43] which outlines the main set of rules and regulations governing operations of insurance business in the country.[44] This Act was subsequently replaced by the *Insurance Act 1996*.[45] The regulation of the insurance industry by the Central Bank also 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.[46] The close supervision of solvency and market conduct along with a strengthened regulatory framework enforced in the 1990s helped to enhance the professional standards in the insurance industry and consumer confidence.[47]

Islam is the predominant religion in Malaysia and also the state religion with 61.3% of the population (approximately 17 million of the total 28.3 million people) practicing Islam.[48] In fact, in the Malaysian context, socio-cultural research findings support the fact that ethnic Malays (who form the Muslim majority population) place

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39 It must be clarified that although the insurance awareness and penetration rate in Malaysia is relatively high compared to other emerging markets in Asia and the Middle East, it is still low when compared to the developed insurance markets of the west.

40 Saudi Arabia is the world's largest *takaful* market accounting for 51% of the Global Gross Takaful Contribution, while Malaysia accounts for around 18% of the Global Gross Takaful Contribution—based on 2012 forecast; see: MEIR, *World Islamic Insurance Directory 2013*, *supra* note 35; and Ernst & Young, "Global Takaful Insights 2013", *supra* note 28.

41 Family *takaful* is a comprehensive range of (Islamic insurance) products for individuals and family such as life, health, accidental, annuity, unit linked plans (that comprises long-term savings in the form of investments) *etc*.

42 See Swiss Re (2008), Sigma Report No. 5/2008, *supra* note 34.

43 Act 89, Malaysia.

44 See Bank Negara Malaysia, "Islamic Banking and Takaful", online: Bank Negara Malaysia <http://www.bnm.gov.my/index.php?ch=fs_mfs&pg=fs_mfs_bank>; see also Bank Negara Malaysia, "Malaysian Takaful Industry 1984-2004", online: Bank Negara Malaysia <http://www.bnm.gov.my/files/publication/tkf/en/2004/booklet.en.pdf>.

45 Act 553, Malaysia.

46 See Thanasegaran, "Growth of Islamic Insurance in Malaysia", *supra* note 5 at 144.

47 See Bank Negara Malaysia, "The Financial Sector Masterplan—Chapter 4: Insurance Sector" at 62, online: Bank Negara Malaysia <http://www.bnm.gov.my/index.php?rp=15> [Bank Negara Malaysia, "The Financial Sector Masterplan"].

48 See Department of Statistics, Malaysia, "Population Distribution and Basic Demographic Characteristic Report 2010" (2010), online: Department of Statistics, Malaysia <http://www.statistics.gov.

a great deal of importance on the fulfilment of their religious obligations and do not separate the teachings of Islam from all aspects of life.[49] The low penetration rate for *takaful* in Malaysia represented a large untapped market and strong growth potential. Hence, the need was to position *takaful* as an alternative to traditional insurance products that was compatible with the religious beliefs of this huge market segment.

In June 1972, the National Fatwa Committee declared that the concept of conventional insurance contravened the rules of Shariah. 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*,[50] thus giving birth to the *Takaful* Scheme in Malaysia and becoming the first country to adopt legislation specifically geared towards *takaful* operations. The operation of *takaful* in Malaysia is regulated by s. 54 of the *Takaful Act 1984* 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*.[51]

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 cooperation amongst the operators in developing the *takaful* industry. Under s. 2 of the *Takaful Act 1984*, *takaful* is defined as: "*a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance in case of need whereby the participants mutually agree to contribute for that purpose*".[52] 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).[53] With the enactment of the *Takaful Act 1984*, the first *takaful* company was established in 1985. Since then, Malaysia's *takaful* industry has been gaining momentum and has been increasingly recognised as a significant contributor to Malaysia's overall Islamic financial system.

The role of *takaful* within the Malaysian secular common law system is clearly delineated by the Malaysian *Federal Constitution*.[54] Although the Central Bank is responsible for administering both *takaful* and conventional insurance, the operation of both industries is mutually exclusive. The financial system in Malaysia consists of a dual financial system, namely: the conventional financial system and the Islamic financial system. This is evident from recently administered separate legislations *i.e.* the *Financial Services Act 2013*[55] (for conventional financial system) and *Islamic*

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my/portal/index.php?option=com_content&id=1215>. See also Pew Research Center, "Global Muslim Population", *supra* note 15.

49 See Asma Abdullah & Lrong Lim,"Cultural Dimensions of Anglos, Australians and Malaysians" 36(2) Malaysian Management Review 1.

50 Act 312, Malaysia.

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

52 *Supra* note 50 [emphasis added].

53 Section 3(1), *ibid.* In the terminology of conventional insurance, family solidarity business refers to life insurance, health insurance, investment linked insurance *etc.* while general business is equivalent to general (or non-life) insurance such as home, motor, travel insurance *etc.*

54 31 August 1957.

55 Act 758, Malaysia [*FSA*].

Financial Services Act 2013[56] (for Islamic financial system) to regulate and supervise the financial system in the country.[57] Section 67(2) of the *Takaful Act 1984* states that the *Insurance Act 1996* (which governs the conventional insurance operations in Malaysia), is not applicable to *takaful* companies.[58] However, *takaful* remains within the purview of civil law jurisdiction.

The article by Thanasegaran has further elucidated that:[59]

> *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 [Shariah] law and the [Shariah] 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*,[60] and is in line with Malaysia being a moderate Islamic country, with [Shariah] 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). Only Saudi Arabia and Sudan take the conservative approach of treating *takaful* as being a part of [Shariah].

In tune with the immense growth of *takaful* in Malaysia, the need was to provide further clarity and develop relevant laws on *takaful* that maintain a balance between the regulatory, legal and religious provisions of Islamic insurance, such that they do not infringe upon each of these institutions. Keeping this in view, the Shariah Advisory Council ("SAC") of Bank Negara Malaysia was established in 1997 as the highest authoritative body in the ascertainment of Shariah matters relating to Islamic finance in the country. The SAC has been given the mandate to ascertain the Islamic law for the purposes of Islamic banking business, *takaful* business, Islamic financial business, Islamic development financial business, or any other businesses, that are based on Shariah principles and are supervised and regulated by the Central Bank of Malaysia.[61] SAC acts as the reference body and advisor to the Central Bank of Malaysia on Shariah matters, and is also responsible for validating all Islamic banking and *takaful* products to ensure their compatibility with Shariah principles. In addition, the SAC advises the Central Bank on any Shariah issues pertaining to Islamic financial businesses or transactions of the Central Bank, as well as other related entities.

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56 Act 759, Malaysia [*IFSA*].

57 The *FSA*, supra note 55 came into force on 30 June 2013, except s. 129 and Schedule 9, see online: Bank Negara Malaysia <http://www.bnm.gov.my/documents/act/en_fsa.pdf>. The *IFSA*, *ibid.*, came into force on 30 June 2013, except paras. 1-10, 13-19 of Schedule 9, see online: Bank Negara of Malaysia <http://www.bnm.gov.my/documents/act/en_ifsa.pdf>.

58 *Supra* note 50.

59 See Thanasegaran, "Growth of Islamic Insurance in Malaysia", *supra* note 5 at 147.

60 *Supra* note 54.

61 See Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance*, 2nd ed. (Kuala Lumpur: Bank Negara Malaysia, 2010) at 15.

Under the provisions of the *Central Bank of Malaysia Act 2009*, the role and functions of the SAC have been further reinforced whereby the SAC is accorded the status as the sole authoritative body on Shariah matters pertaining to Islamic banking, *takaful* and Islamic finance in Malaysia.[62] While the rulings of the SAC are applicable to Islamic financial institutions (under s. 55 of the *Central Bank Act*),[63] the courts and arbitrator are also required to refer to the rulings of the SAC for any proceedings relating to Islamic financial business, and such rulings shall be binding (under s. 56 of the *Central Bank Act*).[64] To further reduce ambiguity between ruling(s) given by Islamic financial institutions and the Shariah Advisory Council, ss. 57 and 58 of the Act clarify that in such scenarios the ruling of the SAC shall prevail and will be binding on the Islamic financial institutions.[65] The SAC comprises prominent scholars and Islamic finance experts, who are qualified individuals with vast experience and knowledge in various fields, especially in finance and Islamic law.

More recently, the *IFSA*[66] provides for the regulation and supervision of Islamic financial institutions, payment systems and other relevant entities and the oversight of the Islamic money market and Islamic foreign exchange market to promote financial stability and compliance with Shariah and for related, consequential or incidental

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62 Act 701, ss. 51, 52 [*Central Bank Act*]. See online: Bank Negara Malaysia (Central Bank of Malaysia) <http://www.bnm.gov.my/documents/act/en_cba.pdf>.

63 *Ibid.*, s. 55:

> The Bank and Islamic financial institutions to consult Shariah Advisory Council
>
> (1) The Bank shall consult the Shariah Advisory Council on any matter—
>
> (*a*) relating to Islamic financial business; and
>
> (*b*) for the purpose of carrying out its functions or conducting its business or affairs under this Act or any other written law in accordance with the Shariah, which requires the ascertainment of Islamic law by the Shariah Advisory Council.
>
> (2) Any Islamic financial institution in respect of its Islamic financial business, may—
>
> (*a*) refer for a ruling; or
>
> (*b*) seek the advice, of the Shariah Advisory Council on the operations of its business in order to ascertain that it does not involve any element which is inconsistent with the Shariah.

64 *Ibid.*, s. 56:

> Shariah Advisory Council for ruling from court or arbitrator
>
> (1) Where in any proceedings relating to Islamic financial business before any court or arbitrator any question arises concerning a Shariah matter, the court or the arbitrator, as the case may be, shall—
>
> (*a*) take into consideration any published rulings of the Shariah Advisory Council; or
>
> (*b*) refer such question to the Shariah Advisory Council for its ruling.
>
> (2) Any request for advice or a ruling of the Shariah Advisory Council under this Act or any other law shall be submitted to the secretariat.

65 *Ibid.*, s. 57: Effect of Shariah rulings—"Any ruling made by the Shariah Advisory Council pursuant to a reference made under this Part shall be binding on the Islamic financial institutions under section 55 and the court or arbitrator making a reference under section 56."
Ibid., s. 58: Shariah Advisory Council ruling prevails—"Where the ruling given by a Shariah body or committee constituted in Malaysia by an Islamic financial institution is different from the ruling given by the Shariah Advisory Council, the ruling of the Shariah Advisory Council shall prevail."

66 Bank Negara Malaysia brought out a document titled "Financial Sector Master Plan" ("FSMP"), see Bank Negara Malaysia, "The Financial Sector Masterplan", *supra* note 47, in the year 2000 which also envisioned a six-point achievement target for the *takaful* market to be achieved in 2010. The document also contained recommendations on how to achieve these targets and were focused on three areas—Institutional capacity enhancement (enhancing efficiency of *takaful* operators, enhancing skill set of manpower employed by and the management team of these operators), financial infrastructure development (measure to deepen the market and to stimulate Islamic financial engineering in product development and risk management), regulatory framework development (to strengthen existing laws

matters.[67] Several aspects of *takaful* business are regulated within the *IFSA*, such as: maintenance of *takaful* funds (Part VI, Division 6), business conduct, complaints, disputes (Part IX, Division 2 and 3) *etc*.[68] The *IFSA* through its comprehensive parts, divisions and sub-divisions provides clarity and transparency to the *takaful* business with detailed interpretations of various entities, laws and their meanings from a regulatory, legal and religious perspective. This ensures that there is no duality in the understanding of the laws and therefore helps in their correct interpretation and implementation by the relevant institution(s).

Rapid liberalisation of Malaysia's Islamic financial industry has encouraged the participation of foreign institutions in Malaysia seeing the growth potential of the insurance sector as well as tapping the need for *takaful* in the market, thus creating a diverse and growing community of domestic and international *takaful* operators. As of 2012, there are 12 *takaful* operators in Malaysia (up from just 7 players in 2007 and 2 players in 2001)[69] offering a range of comprehensive *takaful* products. Total assets of Malaysia's *takaful* industry amounted to US$2.8 billion in 2007 which rose to US$5.5 billion in 2011, whereas the per capita contribution towards *takaful* increased from US$31 to US$55 between 2007 and 2011 respectively.[70] The *takaful* industry in Malaysia has enjoyed a healthy growth of 20 to 25% per year over the past five years. The government has played a critical role through market liberalisation, building Islamic finance foundations and promoting business development across Malaysia. *Takaful* now constitutes 20% of the insurance market share with an effective contribution to the financial sector of the Malaysian economy and it is envisioned that the *takaful* industry landscape would evolve in parallel with the conventional banking and insurance system in the coming years.[71]

Malaysia was one of the first markets to have a specific regulatory framework for the *takaful* business. There are many countries (with the exception of Bahrain, Pakistan, Qatar and Oman) where the lack of consistent governance and regulatory compliance will hamper future growth. Hence, the need is to adapt progressive *takaful* practices for clarity and prudent regulatory supervision—similar to the Malaysian *takaful* market. The AAOIFI emphasises that greater harmonisation and wider application of standards would deliver benefit, especially if the standards can help to give clarity and consequently enhance the confidence of users of Islamic finance products

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and guidelines and to move towards a 'code of ethics' approach from an approach requiring regulatory intervention). See Tobias Frenz, Madhu Sridharan & Krishna Iyer, "Developing a Takaful product in India—Risks and Challenges" 10th Global Conference of Actuaries 44, online: Institute of Actuaries of India <http://www.actuariesindia.org/downloads/gcadata/10thGCA/takaful_madhu.pdf> [Frenz, Sridharan & Iyer, "Developing Takaful in India"].

67 *IFSA*, *supra* note 56.

68 *Ibid.*

69 See Bank Negara Malaysia (Central Bank of Malaysia), "List of Licenced Financial Institutions" (2012), online: Bank Negara Malaysia <http://www.bnm.gov.my/index.php?ch=13&cat=insurance&type=TKF>.

70 See Bank Negara Malaysia (Central Bank of Malaysia), "Annual Takaful Statistics, 2011", online: Bank Negara Malaysia <http://www.bnm.gov.my/index.php?ch=statistic&pg=stats_takaful&eId=box2&lang=en&ac=94>.

71 See Bank Negara Malaysia, "The Financial Sector Masterplan—Chapter 5: Islamic Banking and takaful" Insurance Sector", online: Bank Negara Malaysia <http://www.bnm.gov.my/index.php?rp=16> at 79 [Bank Negara Malaysia, "The Financial Sector Masterplan"]. See also A.M. Best Asia Pacific Weekly Insurance Newsletter, "Malaysia Seeks Takaful Growth With New Regulations" (2011), online: A.M. Best Company Inc. <http://www.ambest.com/bestweek/marketreports/BWAP_Takaful.pdf>.

including *takaful*, and can help to enhance the cost efficiency of Islamic finance operations and product development.[72]

Underpinned by a comprehensive and conducive Shariah and regulatory framework supported by a dedicated institution (*viz*. Shariah commercial court) in a judicial system that addresses legal issues related to *takaful*, Malaysia has emerged as one of the leading *takaful* markets with advanced regulations that encourage and ensure a supportive and facilitating environment to nurture the growth of *takaful* and acts as a major hub for international Islamic finance.[73] As is evident, Malaysia has achieved significant milestones in the development of its *takaful* industry which acts as an exemplar for other Islamic markets to follow. The subsequent section will very briefly elucidate upon the cues that the Indian insurance industry can draw from the success of *takaful* in Malaysia, that could ultimately help in the introduction of *takaful* in India in the near future.

VI. *Takaful* in India: Cues from the Success of *Takaful* in Malaysia

The Indian insurance market has grown remarkably over the past decade, with the enactment of the *Insurance Regulatory and Development Authority* ("IRDA") *Bill* in early 2000 and greater deregulation in 2007. The insurance density (measured as the ratio of premiums underwritten in a given year to the total population) has increased from US$9.9 in 2000 to US$64.4 in 2010, whereas over Financial Years 2003 to 2010, premiums have increased at a compounded annual growth rate ("CAGR") of 25%.[74] This is reflected by intense competition with the entry of new players, introduction of innovative and more customised insurance products, greater emphasis on alternative distribution and delivery channels to reach prospective customers as well as awareness programmes. The insurance industry is projected to register a CAGR of 10% in the next 5 to 6 years. About 30 to 40% of the Indian population needs to be the prime target for future growth of the insurance industry.[75] This is indicative of the high growth potential exhibited by the Indian market where insurance penetration and density measured as a percentage of GDP and insurance premium per capita have considerably increased over the past decade but still remains low when compared with other developing markets.

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72 Quote by Dr. Khaled Al Fakih, Secretary General and CEO, AAOIFI. Referenced from Deloitte, "The Global Takaful Insurance Market: Charting the Road to Mass Markets" (2013), online: Deloitte <http://www.deloitte.com/assets/Dcom-MiddleEast/Local%20Assets/Documents/Centers/Islamic%20fin ance/me_fsi_insurance_takaful_0613.pdf>.

73 See Shahril Azuar Jimin, Presentation on "Evolution of the Malaysian Takaful Industry" (2011), online: Etiqa Takaful Berhad <http://www.academia.edu/4995805/En_Shahril_Azuar_jimin_Evolution_of_Malaysian_Takaful_Industry_150411_Etiqa_Takaful>; see also Ernst & Young, "Global Takaful Insights 2013", *supra* note 28.

74 India Brand Equity Foundation ("IBEF"), "Insurance", Presentation on the Indian Insurance Industry (November 2011), see online: IBEF <http://www.ibef.org/download/Insurance50112.pdf>; see also IRDA, "Annual Report 2010-2011" (2011) at 273, online: IRDA <http://www.irda.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo1583&flag=1&mid=Annual% 20 reports%20%3E%3E%20Annual%20reports%20of%20the%20Authority>.

75 Quote by M. J. Hari Narayan—Chairman (IRDA) during keynote address at the 2009 Annual Summit of the Insurance Brokers Association of India ("IBAI"), see online: The Hindu <http://www.thehindu.com/business/Industry/irda-against-basleii-norms-for-insurance-industry/article53732.ece>.

As far as India is concerned though, there is great potential for *takaful* in view of its substantial Muslim population. India is home to the third largest Muslim population in the world (after Indonesia and Pakistan) with almost 177 million Muslims comprising 14.6% of the country's population.[76] *Takaful* could be one such way to tap into the huge Muslim population which remains un-served and under-served in the country. *Takaful* has not been introduced in India yet. During his tenure, the Reserve Bank of India's[77] Governor, Mr. D. Subbarao ruled out the introduction of Islamic banking and insurance in the country. Citing legal problems and complexities, he said that "*introduction of Islamic finance (banking and insurance) was not possible in absence of a separate law for Islamic banking*".[78] Analysts believe that the launch of Islamic banking and insurance will overcomplicate the financial service industry as of now. To create legislation which allows no interest (*riba*) to be paid or received would mean subjecting ordinary savers to enormous risks—which surely cannot be the intention of Islamic banking. If Islamic banks cannot invest in bonds, T-bills, and commercial paper, or lend to finance inventory or projects for interest, it defeats the whole purpose of banking.[79] Various reports and studies indicate that the introduction of *takaful* in India at this juncture may not be suitable as this will add further complexities to the nascent insurance sector which is still grappling with low awareness, perceived weak value proposition and presumed negativity towards insurance as a concept.

Several reasons are attributed towards low insurance awareness (acceptance) and penetration, in addition to those explained above, other factors being: low purchasing power, prioritising of expenses, positioning of insurance as a tax-saving instrument (under s. 80C of the Indian *Income-tax Act*)[80] and/or merely buying it due to regulatory compulsion (*e.g.*, vehicle third party liability cover, overseas travel insurance to get visa, term insurance to get bank loan *etc.*). Moreover, the notion of insurance not being compatible goes beyond just the Muslim populace. Studies suggest that even other religious groups such as Hindus have been reluctant to buy insurance, although in this case it is not because of some religious law, but because of the embedded psychology of destiny or 'karma', *i.e.* loss or damage that may happen in the future would be attributed to our actions and deeds in the past and hence accepting the occurrence of an event as our fate. Hence their belief system often comes in the way of buying insurance product(s). Therefore, high awareness does not translate into high acceptance of insurance by the people.[81]

In a secular country like India, Islamic insurance (and banking) could be introduced based on similar lines as it has been in Malaysia where Islamic insurance is considered to be part of the mainstream mercantile law and is not governed by

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76 See Pew Research Center, "Global Muslim Population", *supra* note 15 at 13.

77 Reserve Bank of India ("RBI") is India's Central Bank.

78 Press Trust of India ("PTI"), "RBI rules out introduction of Islamic banking" (22 November 2012), online: Business Line <http://www.thehindubusinessline.com/industry-and-economy/banking/rbi-rules-out-introduction-of-islamic-banking/article4123312.ece>.

79 R. Jaganathan, "Islamic Banking is a myth—RBI is right to reject it" (23 November 2012), online: FirstPost Business <http://m.firstpost.com/business/islamic-banking-ismyth-rbi-is-right-to-reject-it-532733.html?page=1>.

80 Act 43 of 1961.

81 National Council of Applied Economic Research ("NCAER"), "India Financial Protection Survey" (2007), online: NCAER <http://www.ncaer.org/downloads/recentreleases/max-ncaer-book.pdf>.

Shariah laws to settle any customer dispute.[82] It is only a matter of time before *takaful* will be introduced in India, though there are certain Shariah-compliant investment funds available squarely aimed at wooing the huge Muslim population which are conscious of their religious principles and ethics while planning or deciding on their investment activities. Seeing the huge potential of this market, Reliance Life has come out with plans where investment of funds is made in Shariah-compliant mode, *e.g.*, Reliance India Shariah Growth Fund invests in listed Shariah-compliant equities of companies. Similarly, Tata Ethical Fund invests in the equity securities of companies involved in a variety of sectors *excluding* liquor, tobacco, consumer goods, and finance and banking. The fund also does not invest in interest-bearing securities.[83] Though these and other investment plans are not *takaful* products per se, it is nonetheless indicative of the shape of things to come in future.

India's IRDA should think in terms of developing the required regulatory framework for *takaful* insurance. The challenge of low insurance penetration and acceptance in India can partly be addressed through *takaful*. But responsibility also lies with the Muslim community in India, especially the educated class, to take initiatives to develop a class of trained professionals who are not only well-versed with Islamic teachings, Quranic injunctions, sayings and traditions of the prophet of Islam, but also have sound knowledge of modern day economic principles and practices. Unless there are qualified and competent people with the proper understanding and insight into the Islamic Shariah and the way that modern economies are run, it will be difficult to constitute a Shariah board to supervise and certify *takaful*. This is a basic requirement if *takaful* is to take root in India.[84] IRDA could form a committee comprising experts from the insurance sector, Muslim scholars, officials from regulatory bodies (both banking and finance) and the judiciary to foresee how Islamic banking and eventually Islamic insurance could be introduced in India in a manner that complements (rather than complicates) the financial services industry in the country and fits within the legal framework of the country. The concluding section below provides certain recommendations and suggestions for taking *takaful* forward, wherein the concept of micro-*takaful* and its relevance for the low-income and religiously conscious markets is discussed, while also outlining challenges and opportunities facing the *takaful* market.

VII. Taking *Takaful* Forward: Recommendations and Suggestions

In the coming years, as the insurance industry in India and other developing markets further matures, the introduction and growth of *takaful* cannot be ruled out and could carve out a niche market for players entering this lucrative segment. The need will also be to sell low cost insurance for the low-income segment with product and service features that are simple and easy to understand while at the same time commensurate with the principles of Islamic finance. The low-income segment refers to the 4 billion

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82 Although it mandates the reference to Shariah rulings given by the SAC which ensures that the Islamic principles and laws are not discounted for, while at the same time maintaining the sanctity of the jurisprudence of the legal system.

83 See online: Bloomberg, <http://www.bloomberg.com/quote/RISGFIN:MP>; Bloomberg <http://www.bloomberg.com/quote/TATCSEQ:IN>.

84 See Qaiser, "Islamic Insurance", *supra* note 5 at 8.

people at the bottom of the economic pyramid ("BOP") with an annual per capita income of less than US$1,500.[85] The BOP represents an enormous untapped market sector previously thought of as unreachable or difficult to reach. Companies that aim to target this vast market segment need to apply innovative business models and practices that can generate value for these underprivileged customers while creating profits. Towards this end 'micro-*takaful*' (*takaful* for the low-income segment) is an emerging segment within the overall *takaful* market space. In order to further enhance the reach of *takaful* (particularly micro-*takaful*) the need is to reinvent the existing marketing strategies as well as distribution and delivery channels which are heavily reliant on direct marketing through agents, brokers or bank assurance.

Certain suggestions to improve awareness towards *takaful* (and micro-*takaful*) and cement its acceptability could be to collaborate with Muslim scholar associations that could issue Shariah-complaint certification to *takaful* products while marketing them. Other ways include engaging local mosques (mosque marketing), marketing to faith-based associations, *maulvis* (scholars or experts in Islamic laws), promoting them from an ethical viewpoint, emphasising the cooperative or mutual nature of insurance, and leveraging the popularity of influential Muslim leaders, thinkers and personalities (like film stars, businessman, social activists *etc.*) to hold awareness workshops organised jointly by the insurance companies and insurance regulators. Such events and seminars could be organised post-Friday prayers and during the holy month of Ramadan and Eid. Insurance companies could also tie up with micro-finance companies and local cooperatives to market, sell and service micro-*takaful* particularly in rural and remote areas in developing countries.

Understanding and exploring micro-*takaful* schemes is especially important for Islamic emerging market countries. Studies suggest that there is evidence of a causal relationship between insurance penetration and economic growth.[86] Hence, Islamic emerging market countries could facilitate economic growth by creating a functioning micro-*takaful* insurance market. India, which was the first country to come up with microinsurance regulations, could help *takaful* operators devise micro-*takaful* regulations commensurate with their market dynamics, while success of the Malaysian *takaful* model (and its *Takaful Act*) could assist Indian regulators and policymakers to ultimately introduce *takaful* in India.

Unlike most Western countries, the bulk of the world's Muslim population is youthful. In fact, 60% of the global Muslim population is under 25 years of age. This youthful population is starting to achieve a certain level of affluence and if it can be captured early, it has the potential to be a customer base to be retained for 40 years or more. The under-insured status of most Muslims is also a significant enticement to potential *takaful* operators and this is where micro-*takaful* could be useful particularly towards targeting low-income Muslims in developing and under-developed markets such as in Africa and Asia.

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85 GDP per capita based on purchasing power parity ("PPP") in US$. See C.K. Prahalad & Stuart L. Hart, "The Fortune at the Bottom of the Pyramid" (2002) 26 Strategy+Business 1.

86 See *e.g.*, Marco Arena, "Does Insurance Market Activity Promote Economic Growth? A Cross-Country Study for Industrialised and Developing Countries" (2008) 75 Journal of Risk and Insurance 921; J. François Outreville, "The Economic Significance of Insurance Markets in Developing Countries" (1990) Journal of Risk and Insurance 487; Stefan Dercon and Martina Kirchberger, "Literature Review on Microinsurance" (2008) Microinsurance Paper No.1, ILO, online: ILO <http://www.ilo.org/public/english/employment/mifacility/download/litreview.pdf>.

The scale and scope of *takaful* is huge and is not only limited to Muslims and Islamic countries, as the essence of Islamic insurance is based on the objective of brotherhood, solidarity and mutual assistance, thus stressing the need for a win-win scenario for all and hence propagating the idea of 'inclusive capitalism' that the world so badly needs. With the recent sub-prime and Eurozone crises and several malpractices in the financial services sector[87] which had global repercussions, *takaful* insurance (and principles of Islamic finance more broadly) shows the way towards purposeful and ethical practices and processes that could provide several cues for a balanced, inclusive and well-developed financial services industry in the future. This combination of an ethical investment policy, significant growth potential and price competitiveness makes for a compelling business proposition to non-Muslims as well, be it in the U.K., the rest of Europe and the U.S. This is a strong driver in markets where the majority of the population is not Muslim. There are two million Muslims in the U.K. and 20 million in Europe, while in the U.S. the estimates range from two million to six million. But if non-Muslims seeking an ethical investment come in as *takaful* customers, the market then becomes one of almost 60 million in Britain and some 450 million in Europe.[88]

In spite of its relevance to the inclusive growth of the global insurance market, several questions and challenges remain for *takaful* operators and the insurance industry in general. First, the biggest challenge is creating customer awareness. Studies suggest that even if there is high insurance awareness, it may not necessarily translate into ownership of insurance as it might not be compatible with their religious sentiments and beliefs. Many Muslims live under the misconception that insurance is contrary to the principles of Islam, particularly with regard to life insurance. People have to be made aware that *takaful* provides an acceptable, religiously validated solution. Similarly, non-Muslims need to be made aware of why *takaful* is ethical. Hence the introduction of innovative *takaful* products, focusing on micro-*takaful*, adopting a differentiated marketing strategy (as explained above) to expand customer reach and post-sales services is the way forward. Secondly, according to Islamic jurisprudence, the objective of *takaful* is not to gain profit but to mutually assist each other.[89] This objective, however, raises the question of whether *takaful* insurance companies can be profit-maximising firms.[90] Thirdly, human resources pose a major obstacle to growth, as the market is facing a severe shortage of qualified staff who understand both technical aspects of insurance and have an adequate awareness of Shariah principles.

Several strategies need to be developed to address the above key issues for *takaful* and micro-*takaful* to gain further inroads into India and such other markets once the markets open up or are more conducive. It will be ideal to first introduce Islamic banking and other parallel financial instruments (such as equity funds)

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87 *E.g.*, Barclays Bank was fined for attempts to manipulate LIBOR rates, HSBC Bank was fined for money laundering *etc*.

88 See PWC, "Takaful: Growth Opportunities in a Dynamic Market" (2008), online: PWC <https://www.pwc.com/en_GX/gx/financial-services/pdf/pwc_takaful.pdf>.

89 See IFSB, "Guiding Principles on Shariah Governance Systems for Institutions Offering Islamic Financial Services" (2009), online: IFSB <http://www.ifsb.org/standard/IFSB-10%20Shariah%20Governance.pdf>.

90 See Muhammed Altuntas, Thomas R. Berry-Stölze & Anja Erlbeck, "Takaful—Charity or Business? Field Study Evidence from Microinsurance Providers" (2011) 30 Journal of Insurance Regulation 339.

that are Shariah-compliant that will in turn create a supportive environment for *takaful* to gradually enter these markets. The need is to emphasise how *takaful* is able to 'manage the meaning and value' that people attach to insurance while making it a legitimate and acceptable product (through the *takaful* model) which hitherto contravened their beliefs and faith.[91] Other steps could be in developing prudent regulations and supervisory oversight guidelines to allow *takaful* companies, and thereafter introducing parallel accounting and reporting guidelines for Islamic financial institutions. The market needs to be strengthened by allowing international operators to provide *takaful* products and funds, capacity and expertise to the local market.[92]

Countries where *takaful* is new must set out clear principles on how *takaful* businesses should be taxed and governed, such that *takaful* is not only Shariah-compliant but also complies with the local national regulatory rules. This calls for delineating between Shariah laws and legal laws[93] where the former can be used to design the product suiting the target market sensitivities, while the latter is used to supervise the operations and overall regulation of *takaful* sector within the ambit of insurance industry and overall financial services sector. For this there is a need to create a regulatory regime that does not treat *takaful* less or more favourably than conventional insurance products.

VIII. Conclusion

Takaful insurance and its operators have positioned themselves to capitalise on the new emerging opportunities. *Takaful* players need to better position themselves to identify key growth drivers and capitalise on the emerging growth opportunities in an increasingly competitive global *takaful* landscape, including considering: strategies to translate such market potential to real growth; new business models; pertinent issues in regulating *takaful* providers; and exploring the latest innovations in the next generation of *takaful* products in light of changing consumer expectations. To conclude, the potential of *takaful* is beyond question. With the increasing interest of leading conventional insurance players and major banks who are moving into the in *takaful* business, the global *takaful* industry is poised for significant growth. To

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[91] Studies have suggested not to merely focus on the marketing mix of 4P's (as in Product, Place, Price, Promotion) but on 4A's as in Awareness, Accessibility, Affordability and Availability: see Jamie Anderson & Neils Billou, "Serving the World's Poor: Innovation at the Base of the Economic Pyramid" (2007) 28(2) Journal of Business Strategy 14; Jamie Anderson & Costas Markides, "Strategic Innovation at the Base of the Economic Pyramid" (2007) 49(1) MIT Sloan Management Review at 83. Of late researchers have also stressed on the need for '*managing meanings and values'* of product and/or service propositions which suffer from low awareness but are also not perceived as attractive, acceptable and affordable by the prospective market segment. This is particularly relevant for the low-income segment (BOP) in emerging markets: see Mohit Anand & Phillipe Monin, "Innovation Processes in Emerging Markets: Empirical Evidence from the Indian Insurance Industry" (2013) 18(1) Management International 40 at 40-57, 172, 175, 178.

[92] There is a serious shortage of both Shariah advisors well versed in *takaful* as well as managers, actuaries, underwriters, accountants, sales agents and investment experts familiar with the Shariah principles: see Frenz, Sridharan & Iyer, "Developing Takaful in India", *supra* note 67 at 79.

[93] Although both institutions need to be in constant dialogue with each other such that there is a provision for regular reference to each other's rulings for clarity and to avoid any conflict between them, similar to the Malaysian Model as espoused under s. 55 of the *Central Bank Act*, *supra* note 63.

grab a larger slice of the competitive *takaful* market, there is a need for operators to unravel the hidden growth areas in *takaful* in order to lead the competition.[94] This paper provided an overview of the evolution and significance of *takaful* globally and more specifically in the Malaysian context by analysing its regulatory framework which remains a leading market in the *takaful* space. In doing so, this study lends insurance regulators and policy makers (in India and other emerging markets) that are contemplating introducing *takaful* useful insights to develop *takaful* in their respective markets.

The success of *takaful* in Malaysia provides several learning(s) for the global insurance industry specifically in terms of regulations that encourage development of the *takaful* market, while positioning it within the purview of civil law jurisdiction could be a starting point when the Indian insurance sector eventually allows operation of *takaful* products. Key areas where stress must be given include: (1) focus on innovative *takaful* products especially on micro-*takaful* to serve low-income Muslim populations in developing markets of Africa and Asia; (2) the need for alternative marketing, distribution and delivery channels for both pre- and post-underwriting services; and (3) making *takaful* compatible with the existing regulatory and legal framework in these and new markets where it may be introduced in the near future. This will eventually help *takaful* further complement the growth of the insurance industry and the financial services sector while at the same time achieving financial inclusion.

[94] 7th Annual Takaful Conference, 9-10 May 2012, Singapore, online: Asia Insurance Review <http://www.asiainsurancereview.com/Portals/1139/pdf/12-AsianTakaful.pdf>.